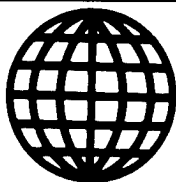


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19 FEBRUARY 1988



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# **China**

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# China

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## NATIONAL AFFAIRS, POLICY

### Review of Double-Track Price System for Pricing Means of Production

40060053 Beijing JIAGE LILUN YU SHIJIAN  
[PRICE: THEORY AND PRACTICE] in Chinese  
No 5, 20 Sep 87 pp 15-16, 62

[Article by Li Baoshi [2621 1405 1395], Wang Shiyuan [3769 0099 0334] and Cai Xiaobin [5591 2556 2430] of the State Commission for the Restructuring of the Economic System: "A Review of the Double-Track Price System for the Means of Production"]

[Text] The double-track price system represents a unique transitional phase for setting prices for the means of production during the reform of the circulation system in our nation. This article is an attempt to review the trend of development of the transitional phase for the setting of prices and to suggest further reforms by reviewing the emergence of the double-track price system and analyzing its advantages and disadvantages.

#### The Origin and Accurate Picture of the Double-track Price System

The double-track price system is a result of the reform of our traditional system for planning and distribution of supplies. It accompanies the enlargement of the autonomous powers of the enterprises in their production operations and is immune to the subjective desires of people. By the "double-track price system" for the means of production, we are referring to the existence of two different prices for the same product inside and outside the plan. Prices for products within the state allocation plan are set uniformly by the state, while prices for products to be circulated on the market are set by the enterprises themselves or are determined in part by what the enterprise assigns and what the market will bear. Of course, different prices may be charged for the same products regardless of whether they are inside or outside the plan. That, however, has nothing to do with the double-track price system.

It is difficult to determine exactly when the "double-track price system" first came into being, since a few products outside the plan had been allowed to be sold in the marketplace in the past. While it is true that greater leeway has been given to the enterprises in marketing their products and setting their prices since 1979, the prices of products outside the plan were, nevertheless, under relatively strict control. For example, the prices for 2 percent of the energy resources and raw materials within the plan are set by the enterprises. At their highest, however, these prices cannot exceed 20 percent of that set by the state. Later, as the enterprises were gradually allowed to sell a larger percentage of their products within the plan, all products that were over and above the plan. In 1985, restrictions were removed

from the limitations set on the range that prices were allowed to float and the transitional form of the double-track price system was created.

At the moment, the major means of production within the double-track price system include primary and secondary resources, crude-oil products, coke, pig iron, steel products, wood products, cement, metal materials, plate glass, and mineral products. There has been a considerable gap between market prices and prices according to the state plan for major raw materials since the formal adoption of the double-track price system 3 years ago. At one time, market prices for such products as steel exceeded planned prices by over 200 percent. Since last year, however, the gap has been reduced as a result of changes in supply and demand.

The adoption of the double-track price system represents a major reform of the circulation system for the means of production. Previously our circulation system for the means of production was basically shaped according to the planned distribution pattern set by the units at various administrative levels. As a result, a serious gap was created between the prices and the true values of products in general and primary products in particular, causing the production enterprises to lose their enthusiasm and creating a long-term shortage of energy resources and raw materials. At the same time, the overconcentration of control over prices led to the ossification of the control system so that prices could no longer reflect supply and demand situation. Following the reform of the state plan and the supply system, their numbers were reduced to 581 and 20, respectively, by 1987. State allocation was reduced from 74.3 to 47.1 percent for steel products, 57.9 to 47.2 percent for coal, 80.9 to 27.6 percent for wood, and 35 to 15.6 percent for cement. That has led to the adoption of the double-track price system for the major means of production which has made it possible to put a certain amount of such production in circulation in the commodities market, to make natural resources available to the market, and to enlarge the market for the means of production.

#### Advantages and Disadvantages of the Double-track Price System

When the double-track price system for the means of production is adopted and developed while the new and the old systems continue to exist side by side, conflict and contradictions are inevitable. It is for this reason that the double-track price system has its advantages and disadvantages. The advantages of the double-track price system are: 1. As a transitional phase, the double-track price system is better able to adapt itself to the financial resources of the state, to contribute to the development of the market, and to add to the adaptability of the enterprises. Due to the moderate changes, repercussions, and risks it has brought on, the system is more acceptable to both producers and consumers. 2. Changes in the disparity between prices within and outside the plan provided a general basis for the readjustment of prices



according to the plan and the further lifting of restrictions. The "interaction" of this mechanism and the increase in the weighted average between planned prices and market prices represent an improvement over the setting of arbitrarily low prices in the past, help to pave the way for the adoption of a reasonable single-track price system during the transitional period, and make it easier to use prices as a major lever to bring about macro-level adjustments and to exercise better control. 3. Under the double-track price system, the production enterprises, by marketing their products outside the plan, are able to increase their incomes, to consolidate their autonomous powers in production, supply, and marketing, to bring their enthusiasm into play, to increase the production of commodities in short supply, to add to the resources of the market, and to improve product structure. 4. The double-track price system also serves to send the message to the processing enterprises that they must take note of market conditions, reduce production costs, and increase their economic effectiveness. 5. The system reduces the scope of allocations by the state, expands the market, decreases the number of commodities whose prices are set by the state, and increases the range and proportion of products sold at market prices. The greatest advantage of the system is that it helps to develop the market for the means of production, to promote lateral relations among the enterprises, to free the enterprises from administrative restraints and dependence on allocations by the state, and to bring about a new economic order whereby the market is adjusted and controlled by the state and guidance for the enterprises is provided by the market.

It is obvious that the double-track price system has certain disadvantages as well. 1. The excessive price gap in the system had led enterprises to be much too concerned over their own interests and to fail to fully carry out the mandatory plan for the supply of commodities, thus dealing a blow to the state plan and jeopardizing the fulfillment of the quota. 2. Prices in the double-track price system cannot help but present a false picture of market conditions because, with the decrease of certain major raw materials put in the market and the increase in their demand, the contradiction between supply and demand as reflected in market prices is in reality greater than that reflected in the traditional single-track price system. Since the shortage of supplies is more serious than it appears, commodities in short supply have in fact become all-purpose "hard currency." This situation has led to panic buying and hoarding and an increase in the amount of commodities in short supply kept in storage. 3. When market control is inadequate, the considerable disparity in prices in the double-track system creates loopholes which tend to foster undesirable tendencies and to encourage speculation and profiteering.

The double-track price system has, in short, not only pointed the way to reforming and developing the market for the means of production, but also set a new target for the reform of macrolevel control and the mechanism for economic operations. By continuing to extend the

reform of the double-track price system, it is possible to increase its advantages, to reduce its disadvantages gradually, and to bring about changes in the pricing system.

#### **Development Trends of the Double-track Price System**

The emergence and development of the double-track price system for the means of production constitutes a transitional phase in the reform of the price system. Its advantages and disadvantages reflect the frictions and contradictions between the new and the old systems as well as the objective reality of an imbalance between the supply and demand of the major means of production. In order to engage in further price reforms and to make use of the double-track price system as a means of establishing a new pricing system, it is imperative that we develop the positive aspects of the double-track price system to the fullest extent and reduce its negative aspects to a minimum.

To bring this about, it is necessary to create three conditions. First, it is necessary to improve the supply-and-demand situation and to gradually bring a buyer's market into being. The basic balance between the total amounts of supply and demand of the means of production and the proper structure of such commodities are essential material conditions for the eventual abandonment of the double-track price system. The achievement of a limited balance in certain products in certain areas would also be conducive to the opening up of the market for single products in certain localities. Second, it is necessary to develop the market to an adequate extent. Among other things, this calls for the signing of contracts relating to direct purchasing and marketing transactions between large and medium-sized production enterprises and their consumers, the extensive establishment of tangible markets, the regularization of administrative procedures, the establishment of a proper network for the circulation of the means of production, and the establishment of business units engaged in operations involving the means of production. Third, it is necessary to engage in a series of reforms of the planned investment system, the reduction of the scope of the safety net, and the steering of major investments toward the enterprises.

It may be seen from the emergence and the trend of development of the double-track price system for the means of production that the further reform of the circulation system calls for the establishment of a proper relationship between development and reform and the further trimming of the variety and scope of supplies allocated by the state, while positive effort is being made to achieve a balance between the supply and demand of the means of production and other commodities, to reduce the number of commodities whose prices are set by the state, to enlarge the scope of commodities whose prices are subject to guidance provided by the state as well as commodities whose prices are determined by the market, to adopt the progressive method of both relaxing and exercising control, of exercising a limited amount of

control and decontrol, of resorting to both control and decontrol, and of reducing the gap between controlled and market prices. As for commodities exclusively allocated by the state, orders for such commodities should be placed by the state and contracts should be signed by the enterprises stipulating their delivery at designated locations. Regarding commodities designated for the market, it is important that binding contracts for the purchasing and marketing of such commodities at prices agreed upon should be signed by the parties concerned. For commodities that require transshipment, the consumer should be allowed to commission enterprises engaged in the handling of supplies to serve as their agents or to sell such supplies on a commission basis. After the establishment of regional markets, efforts should be made to develop a nationwide market and to strengthen its control. The buying and marketing of supplies by the enterprises should be conducted in a businesslike manner, prices should be kept down, and the responsibility for regulating the market should be assumed by a storage company set up by the government.

9621/06662

**Yu Guangyuan on Contract System**

40060065 Beijing XIN GUANCHA [NEW  
OBSERVATIONS] in Chinese No 20, 25 Oct 87 p 2

[Article by Yu Guangyuan [0060 0342 6678]: "Contract System and the Initial Stage of Socialism"]

[Text] Let us consider this: why has the contract system finally taken off? Is it because this piece of reform requires no money from the national coffers? Reform measures whose implementation need a huge infusion of government money do not work these days. The contract system, on the contrary, not only requires no government funding but is actually certain to increase government revenues. At a recent meeting, I heard a comrade remark that government incomes from profit taxes would have been higher without the contract system and that the state in fact does pay for this system. His calculation was made on the assumption that factories would have performed just as well economically in the absence of the contract system. He left out of account the fact that had they not gone in for contracting, factories would not have improved their economic returns so substantially. Thus his calculation seems to me not all that scientific.

Let's consider further: why has the contract system finally taken off? Is it because it is acceptable to the broad ranks of workers? In the case of a complicated piece of reform, workers may fail to grasp immediately the benefits of their effort to the state, their enterprise, and themselves as their educational standard cannot be raised to the required level overnight. However, everybody from top to bottom can figure out the contract system. The result is a much more enthusiastic labor

force. Reform is an act that works from bottom to top as well as from top to bottom. Popular enthusiasm or the lack of it has a vital impact on the success of reform.

I see this as the coming together of the review of the contracting experience and the emphasis by the CPC Central Committee on the notion that China is in the initial stage of socialism because a dearth of financial resources and low educational standards are the very characteristics of the present stage of Chinese socialism. The goal of our reform and construction is to put an end to this situation, but we must take what we have as the starting point. The contracting experience must be reviewed in the context of the initial stage of Chinese socialism, as must construction and other reforms. This is the first point that comes to my mind.

The managerial responsibility system, of which the contract system is a part, is a breakthrough in urban economic reform. But reforms must be coordinated if they are to be effective and lasting. And they must be focused. What is the breakthrough? What is the focus? I think the contract system should be the focus around which other coordinated reforms revolve. This is the second point that occurs to me.

Not only does the managerial responsibility system come in different forms and shapes, including contracting and leasing, but the contract system itself appears in many versions. Capital Iron and Steel Works turns over profits according to a graduated scale. That is one version. Another version—"two guarantees and one linkage"—can be found at the No.1 Machine Tool Factory. There are others. We should allow people to innovate and protect their innovations. Only when there is a variety of innovations can we have enough options to suit different circumstances. The system must be standardized, but not too soon or too rigidly. Otherwise creativity will be stifled and a single system would be imposed across the board. We should reconcile innovation with choice when it comes to implementing the contract system, which can assume one of many forms. This is the third point that occurs to me.

I believe the initial stage of Chinese socialism will go on for a long time and can inevitably be divided into many phases. Actually one phase was now behind us: "the beginnings," 1957-1978, when we had no experience in socialist construction, when we were already in the initial stage of socialism but did not know this basic fact (both unavoidable), and when we committed "left" errors for many years, leading to economic stagnation. Right now we are in the second phase, the phase of reform that began in 1979. Reform in this phase has specific demands. Thus when our set objectives are met, this phase will come to an end and we will move on to the third phase. By that time, we will have created a system that can powerfully stimulate the development of social productive forces. The new system will remain stable for a considerable period of time, during which China's

socialist economy and culture will grow smoothly. Certainly the socialist system will continue to evolve in the third phase, but in a way different from that in the reform phase. It will be altogether a more stable system.

We are now in the second phase of the initial stage of socialism—the reform phase. The present phase is a time when the socialist system undergoes rapid changes. What happens in this phase tends to be largely transitional. There are two kinds of transitory things in the reform phase. One consists of the results of an eclectic process—selecting parts of the new system and parts of the old system, which is to be discarded, and putting them together. At the end of the transitional phase, new things are preserved and amplified, while old things are gradually eliminated. The second kind consists of entirely new, but still immature, things. When the transitional phase comes to an end, immature things will be replaced by mature ones. The final phase of reform will see these two kinds of transitional things become new mature institutions.

In my opinion, the contract system belongs to the second kind of transitional things. I do not know at this point in time which aspects of the contract system will go on to become elements of the new stable institution in the third phase of the initial stage of socialism and which will be replaced by mature things. Only practice and history can tell us. One thing, however, is certain beyond doubt: the contract system is now on the rise and will be here to stay for a long time. The mission now is to pursue it actively and gradually in accordance with the actual circumstances, strengthening and furthering it by making it better and better.

12581

**JINGJI YANJIU on Inflation Mechanisms, Forms**

40060093 Beijing JINGJI YANJIU [ECONOMIC RESEARCH] in Chinese No 11, 20 Nov 87 pp 21-28]

[Article by He Daofeng [0149 6670 1496], Duan Yingbi [3008 2019 4310], and Yuan Chongfa [5913 1504 3127] of the Rural Development Research Center under the State Council—article revised in August 1987; "The Causative Mechanisms and Structural Manifestations of Inflation in China in Recent Years"]

[Text] Since the 3d Plenary Session of the 11th CPC Central Committee, there has been high-speed growth of our national economy, and there has also been an annual average growth in actual national income of 8.6 percent over the period 1979-1986, calculated on the basis of comparable prices. In 1984, the growth was 13.5 percent, in 1985, 12.3 percent and in 1986 it was 7.4 percent. At the same time, the overall retail price index and the total price index of living costs for staff and workers, as compared to the previous year, were respectively: for 1984, 102.8 percent and 102.7 percent; for 1985, 108.8 percent and 111.9 percent; and for 1986, 109 percent

and 107 percent. (Footnote 1) (See "Statistical Yearbook of China" 1981-1986 volumes) Clearly, the concurrent appearance of the swift growth of the national economy and sustained, mild inflation is a fact which we cannot avoid.

It is not enough to simply look at the inflation rate in assessing whether the economic activities of a country are normal or not and whether they are good or not. In the modern world, virtually every country has inflation to differing degrees. According to World Bank figures on 128 countries and regions, in looking at the average inflation rates of the years 1973 to 1984, for 36 low-income countries it was 5.9 percent; for 40 lower-middle income countries it was 20.6 percent; for 20 upper-middle income countries it was 4 percent; for 5 high-income oil-exporting countries it was 11.8 percent; and for 11 market-economy industrialized countries it was 7.9 percent. Among the East European countries, Hungary and Poland which had comparable records, had inflation rates of 4.3 percent and 19.4 percent respectively. (Footnote 2) (See World Bank "1985 World Development Report," ZHONGGUO CAIZHENG JINGJI CHUBANSHE, 1985) It can be said that mild inflation is a normal phenomenon in the process of modern economic activity. Of course, in different countries there are different degrees of inflation, different causative mechanisms and different effects on economic development.

We believe that the mild inflation which has occurred in our country in the last few years is an unavoidable phenomenon in the process by which the old mechanisms change to new mechanisms. An excessively swift rise in the circulating money supply is a surface cause; the expansion of consumption by individuals and collectives leading to consumption inflation, as well as the investment excitement by plural entities leading to investment inflation are intermediate-level causes; and the transitional forms in the process of enterprise organizational and institutional reform, with the handing down of power and allowing the retention of profits as the central aspects, leading to the contraction of enterprises' internal resource accumulation and the expansion of external resource accumulation, are deep-level causes.

**I. The Deep-Level Causes of Mild Inflation in the Existing Enterprise System**

The enterprise system is an organizational form which determines investment and management, as well as a microeconomic balancing mechanism forming accumulation funds and consumption funds. Prior to the economic structural reforms, the accumulation and consumption of our country's state enterprises was subject to the unified receipt and expenditure by the central financial administration. This was realized through strict supervision of enterprises' finances and through compulsory wage control. This meant that enterprises did not have any vigor and were of low efficiency. After the 3d Plenary Session of the 11th CPC Central Committee, the

reform of this ossified enterprise system began. The first step of the reform was centered on the handing down of power and allowing the retention of profits. The implementation of this first step has had the enlivening of the enterprises as its goal. Enterprises are now equipped with certain profit motive and operational autonomy, the sensitivity of the enterprises to the markets has increased, production enthusiasm has grown and these factors have stimulated quite swift growth of the economy. This is the main trend in enterprise structural reform.

However, after enterprises' decision-making power was expanded, no firm organizational forms were established in respect to ownership representatives of the enterprises' assets or operational legal persons, and together with some reform measures already implemented (such as enterprise leaders' income coming from the enterprise, linking up the amount of profit retained by an enterprise and the bonus income with enterprise profits, democratic election of factory managers, factory manager tenure systems and so on), this meant that enterprises were in name state-owned, but in fact enterprise-owned. This was centrally manifested in the fact that regardless of whether enterprise leaders wanted to increase their own income or continue in their post, in all matters they had to win the trust of the workers. To do this they had to try to obtain more benefits for the workers, and there thereby widely existed a mechanism by which workers thirsted for increased wages. The result was that there was a similarity in the interests which the enterprise leaders and the workers each obtained, and thereby it led to their impulses for seeking increased consumption funds from the enterprise's profits to move in the same direction.

As basic wages are subject to strict control by the state, the common-directional impulse for increased consumption funds was mainly manifested as an impulse for retention of profits by the enterprise and an impulse for retained profits to be used for consumption. On the one hand, enterprises' retained profits were as far as possible mostly used for current consumption. This was mainly manifested by increased issue of bonuses and various subsidies, the issue of material goods and increased non-productive investment, especially housing investment and so on. According to statistics, the average annual money-form wage increases in state enterprises from 1981 to 1986 was 17.5 percent, while the bonuses and subsidies which came from the distribution of "retained profits" grew by 25.7 percent annually. During the period from the First 5-Year Plan to the Fifth 5-Year Plan, of the capital construction investment in whole-people ownership enterprises, non-productive construction investment constituted from 14.6 percent to 33 percent. Of this, investment in housing constituted 4 percent to 11.8 percent of total investment. From 1981 to 1985, the proportion of non-productive construction investment of total investment was 40.3 percent to 45.5 percent, while investment in housing constituted 18.2 percent to 25.4 percent of total investment. (Footnote 3)

(See "Statistical Yearbook of China" 1981, 1983, 1984 and 1986) We refer to this activity of enterprises in using as much of the retained profits as possible in increasing consumption as "the contraction of enterprises' internal resource accumulation." On the other hand the increasing of the enterprise's consumption funds does not only rely on the raising of the proportion of retained profits used for consumption, but more importantly on increasing the total amount of the enterprise's retained profits. There are three major ways to increase the total amount of an enterprise's retained profits. The first is haggling with the upper-level responsible department and striving to reduce the rate of regulatory tax which is levied after the income tax. The second is increasing the total profits of the enterprise by increased investment, thereby increasing the amount of profits retained by the enterprise. According to statistics, the fixed proportional increase for total fixed-asset investment in whole-people ownership enterprises from 1983 to 1986 was 26.8 percent. Of this, newly added investment (capital construction investment) was to grow annually at 24.7 percent and replacement investment (renewal and transformation investment) was to grow annually by 30 percent. However, according to an investigation of enterprise investment carried out by the State Statistical Bureau in 1986, enterprises often used renewal and transformation investment for carrying out capital construction. In the first half of 1986 alone just in Beijing, Tianjin and Liaoning this wrongly used component totaled 1.5 billion yuan. According to estimates, the annual growth rate in investment in new additions (capital construction investment) in whole-people ownership enterprises from 1984 to 1986 was actually over 30 percent. (Footnote 4) ("Statistical Yearbook of China" 1986) The third is seeking to raise prices within the narrow range allowed by price controls or, under the double-track pricing system, seeking to sell more at negotiated prices. We refer to this practice by enterprises of increasing enterprise investment mainly through using credit and other social funds and thereby increasing the total amount of profits retained by the enterprise, as "the expansion of external resource accumulation."

The contraction of enterprises' internal resource accumulation and the expansion of external resource accumulation lead to the internal trends of expansion of investment, expansion of consumption income and growth in the prices of products in short supply and labor service. If the credit mechanism lacks effective restrictions, the consumer goods market lacks effective guidance, and this tendency of expansion can easily lead to demand inflation which will in turn stimulate price rises.

The reform of the enterprise system pounds at the existing balancing mechanism for the distribution of national income, and demands the formation of a new control and balance mechanism, so that gradually enterprises' wage income and the financial administration will be separated from one another, and only the wages of organs and institutional units will have any connection with the financial administration. However, the

wage system by which the financial administration is responsible for unified receipts and expenditure and the labor system under which the staff and workers of enterprises have life-long insurance, which have existed for over 30 years, have a strong momentum. All enterprises and institutional units had to abide by the regulations in obtaining wages, and wages could only be adjusted by the financial administration. Each department got a share and all had to have equal portions. Thus, balancing between the departments met unprecedented difficulties. The practice of wage reform since 1978 has shown that each time there was wage regulation by the financial administration, it set off a cycle of higher wage demands. Thus the goal of changing the irrational wage relationship between departments through readjusting wages could not be realized. For example in 1982 the wages of the staff and workers of institutional units were all raised one grade. In 1983-1984, there was no option but to give the staff and workers of enterprises a one-grade rise in wages. In 1984, the State Council issued the "Notice on the Issuing of Bonuses in State Enterprises." This stipulated that enterprises could take out and use bonuses from their economic benefit, that the ceiling on bonuses was abolished, and that the bonuses could be used in floating wage levels for staff and workers or in wage reform. Normally, this would have been an important step in the separation of enterprise wages and the financial administration. However, in 1985 after organs and institutional enterprises implemented the structural wage system with wages being linked to specific posts as an important component, it evoked strong reaction in the enterprises. The result was that enterprises had to be allowed to follow the institutional units in self-funded coordinated reform, and in 1986 the State Council agreed that 7.5 yuan per person per month could be included in costs for enterprises to carry out self-funded coordinated reform.

Under conditions whereby adjustment of wages by the financial administration was not effective in achieving balance, it was demanded that the innate tendency of income balancing would be to continually seek various income-expanding forms. One of the fairly standard forms of this was to expand group consumption under the name of collective welfare benefits. According to statistics, from 1981 to 1986 consumption by social groups grew annually by 17.8 percent. Of this, the annual growth from 1983 to 1986 was 21.8 percent. (Footnote 5) ("Statistical Yearbook of China" 1986)

Adjustment of wages by the financial administration and the expansion of group consumption inevitably led to the growth of financial expenditure, especially consumption expenditure. From 1981 to 1985, financial income grew annually by 11.3 percent, and financial expenditure, economic construction funds grew annually by 10.4 percent, social, cultural and educational expenditure grew annually by 14.8 percent and administrative management expenditure grew annually by 20.8 percent. (Footnote 6) (Ibid.) It can be seen that the annual growth of consumption expenditure in financial expenditure

greatly exceeded the annual growth in financial income. This resulted in tight budgets and the financial administration had to overdraw from banks.

It is insufficient to use only "the seeking of comparable benefits" to explain the pursuit of increased income and consumption between enterprises and between enterprises and institutional units. This is because the seeking of comparable benefits is a normal comparative mentality and to some degree it can even be said that the mentality of striving for comparable benefits is a boosting force in socioeconomic progress. The problem lies not in the existence of the mentality of seeking for comparable benefits, but whether or not there exists an enterprise system which forms an effective restriction on this mentality. Our country's urban workers have lived through the last 30-plus years in a special structural environment. On the one hand this system, through forced separation of the city and the countryside, guaranteed the employment stability of urban workers. On the other hand, through an all-inclusive welfare distribution system, it guaranteed that the urban workers had higher incomes than those in the rural areas. The reforms of the rural economic structure effected a restructuring of the rural microeconomic production organizations. This resulted in financial relationships, decisionmaking and risks becoming clear and consistent, and on the basis of generally increasing income, peasants' income disparities are now being widened. However, the giving of publicity to and talking about some peasants' incomes has broken down the traditional mentality, which has formed over time, that "peasants should be poorer than workers," causing urban staff and workers to have a "relative loss" mentality. This has stimulated an unrestrained seeking of comparable benefits. A survey investigation of staff and workers of state commercial operations in Shenyang City showed that 92.4 percent of the people preferred to continue as staff and workers of state commerce and did not want to become individual commercial retailers. While 97.1 percent of the people proposed that the wages and bonuses of staff and workers be linked with enterprises' profits, 74.3 percent of the people opposed enterprises taking responsibility for losses. (Footnote 7) (See He Daofeng [0149 6670 1496], "The Difficult Change" in NONGCUN WENTI LUNTAN [RURAL ISSUES FORUM], 1987, No 5) This mentality, of seeking for comparable benefits and only being willing to take responsibility for profits and not take responsibility for losses, is encouraged by the current enterprise system. Naturally it will result in the expansion of consumption by enterprises, institutions and also the financial administration. According to statistics, from 1983 to 1986 the labor productivity of whole-people ownership industrial enterprises grew annually by 6.6 percent. However, in the same period, the money wages of whole-people ownership system staff and workers, after excluding growth in prices, rose annually by 7.3 percent. If the intangible income of welfare distribution is added, the actual annual increase was 16.8 percent. (Footnote 8) ("Statistical Yearbook of China" 1984, 1985 and 1986)

After the reform of the investment structure and the implementation of the financial contracts, the ratio between expenditure outside the budget and expenditure within the budget rose from the 1980 figure of 51.4 percent to the 1985 figure of 82.3 percent. The main investors thus changed from the central government as a unitary force to a more diverse situation, and the proportion of state budgetary investment in total social investment in fixed assets fell from the 1981 figure of 29.4 percent to the 1985 figure of 17.6 percent. (Footnote 9) (Ibid.) In the situation where the investors have become plural, the administrative control of investment has become weak and without force, and can only play an emergency brake function. It cannot play a regular microeconomic regulatory role. Thus regular, partial and structural investment regulation must be achieved

through reliance on credit regulation. However, the state enterprises do not react very sensitively to interest rate signals due to their soft budgetary restrictions. Thus raising the interest rates will not inhibit the expansion of enterprises' external resource accumulation, and instead will likely directly increase costs and cause financial problems. This means that bank interest rates are lower than the equilibrium interest rates. However, low interest rates also stimulate collective enterprises and village and township enterprises to proliferate as investing entities. Apart from this, the consumption by those groups which have the financial administration and enterprise units as support has low income flexibility in terms of prices, while the investment these require be drawn in is also inflexible in terms of fluctuations in interest rates. This inevitably means that credit expansion and an investment gap will occur.

## II. Excessive Money Supply Is the Surface Cause of Inflation

Table 1 has been compiled from statistics.

Table 1. Production and Use Volumes of National Income (Unit: 100 million yuan)

Year	Material production sector wages	Non-material production sector wages	Consumption by individual peasant and urban households	Collective consumption and welfare-nature consumption	Total social net investment	Amount of national income used in year	Amount of national income produced in year	Account differential in use of national income for year
	1	2	3	4	5	6	7	8
	$W_1$	$W_2$	$C_1$	$C_2 = \text{labor insurance benefits + social assistance + institutional costs less personnel costs}$	$I = \text{Net investment in fixed assets + newly-added circulating funds}$	$Y_1 = W_1 + W_2 + C_1 + C_2 + I$	$Y_2$	$Y_3 = Y_2 - Y_1$
1981	670	184.4	1530.6	413.4	1109.9	3908.6	3940	+31.4
1982	711.9	205.6	1779.6	461.4	1195.7	4354.2	4261	-93.2
1983	747.9	223.4	1966	524.8	1428	4890.1	4730	-160.1
1984	917.3	259.9	2260.9	607.5	2261.7	6307.3	5630	-677.3
1985	1050.3	338.0	2681.3	666.9	2816.2	7552.7	6822	-730.7

Source of data: "Statistical Yearbook of China" volumes from 1981 to 1986.

From the chart we can see that during the 5-Year Plan period, the growth of income, group consumption and investment all far exceeded the growth of national income. This was especially so after 1983. From 1983 to 1985 the total wages of material production departments grew annually by 18.5 percent, the total wages of non-material production wages grew annually by 23 percent, the consumption of individual households in the rural areas and cities grew annually by 16.8 percent, and net social investment grew annually by 40 percent. All of these surpassed the annual growth in national income of 12.8 percent. The result was that in 4 out of these 5 years, the amount of national income used resulted in a deficit

in that year's accounts, and the accumulated deficit totaled 162.9 billion yuan.

The above-noted account deficit in the production and use of national income could have been improved by readjustment of imports and exports and of international capital circulation. However, from the formation process of total commodity demand and commodity supply as detailed in Table 2, we can see that the national income use deficit for the year could not have been entirely eliminated by the readjustment of imports and exports and of international capital circulation.

Table 2. Formation Process of Total Commodity Demand and Total Commodity Supply  
(Unit: 100 million yuan)

Year	Resi- dents' con- sump- tion	Group con- sump- tion	Net fixed asset invest- ment	Newly- added circulat- ing funds	Exports and inflow of foreign funds	Resi- dents' elastic prefer- ences	Total demand pressure	Total demand	Total demand	Ratio between demand pressure and supply	Ratio between actual demand and total supply	National overall retail price index
	1	2	3	4	5	6	7	8	9	10	11	12
	$C_1 =$ expen- diture by resi- dents in pur- chasing com- modi- ties + resi- dents' expen- diture on cul- tural life ser- vice	$C_2 =$ pur- chases for group con- sump- tion	$K_1 =$ total amount of fixed asset invest- ment - depreci- ation - foreign funds used	$K_2 =$ circulat- ing funds issued by the finan- cial admin- istra- tion + circulat- ing funds issued as credit by banks + enter- prises' own circulat- ing funds	$E =$ exports + for- eign funds used + pur- chases by for- eign resi- dents in this country	$A =$ cash in resi- dents' hands + resi- dents' current accounts	$D' = C_1$ + $C_2$ + $K_1$ + $K_2$ + $E$ + $A$	$D = D'$ - $A$	$S =$ national income + imports and funds outflow - peas- ants' self- sup- plied con- sump- tion	$D'/S$	$D/S$	$P$
1981	1913.1	204	730.9	379	454.4	463.5	4144.9	3681.4	3623.2	114.3%	101.6%	102.4
1982	2082.2	225.4	939.4	256.3	456	540.7	4500.6	3959.3	3834.4	117.4%	103.3%	101.9
1983	2308.6	256.6	1069.6	358.4	458.7	673.8	5125.7	4451.9	4281.5	119.7%	103.9%	101.5
1984	2751.6	324.7	1472	789.7	598.5	973.8	6910.3	5936.5	5286.2	130.7%	112.3%	102.8
1985	3609.8	410	2079	737.2	895.6	1248.8	8980.4	7731.6	6914	129.9%	111.8%	108.8
1986	—	—	—	—	—	—	—	—	—	—	—	106.0

Sources of data: "Statistical Yearbook of China" volumes for 1981 to 1986 and "Financial Statistics Summary" (1952-1985).

From column 10 in Table 2, we can see that if we take residents' flexible preferences as short-term market demand pressure, then when the amount by which demand pressure exceeds supply remains below 20 percent, inflation can be maintained at under 4 percent. If the degree of excess approaches 30 percent then the inflation rate will rise to above 7 percent. Of course, if we see residents' flexible preferences as the normal volume of money detained in circulation after the number of detention links increases, then it does not constitute latent demand pressure. From the ratio differential between total actual demand and total actual supply and the price indices, set down in columns 11 and 12, we can see that there exists, between the gap which occurs between total actual demand and total actual supply and

the overall retail price index, a quite close relationship, which is subject to a 1 year lag. That is, the expansion of the differential between demand and supply is reflected as an increase in prices in the following year. On the basis of a correlational analysis of columns 11 and 12, the quasi-general line model is  $P_t = 42.18 + 0.58 (D/S)_{t-1}$ .

The correlational coefficient for testing this model is  $R = 0.945$ , and this shows that there is a close direct relationship between  $P_t$  and  $(D/S)_{t-1}$ .

The above-mentioned gap between the total demand and total supply finally forces banks to provide a remedy in terms of money supply, and this leads to the occurrence of inflation.

Table 3. Money Circulation Volumes in the Market and Inflation

Year	Growth in cash volume for year (percentage)	Growth in money volume for year (percentage)	Growth in volume of commodity retail sales in society (percentage)	Growth in national income (percentage)	Velocity of circulation of $M_0$	Elasticity of $M_0$ in respect of national income	Elasticity of $M_1$ in respect of national income	National overall retail price index	Staff and workers' living costs price index
	1	2	3	4	5	6	7	8	9
	$gDM_0/M_0$	$gDM_1/M_1$	$gDC/C$	$gDY/Y$	$C/M_0$	$gDM_0/M_0 / gDY/Y$	$gDM_1/M_1 / gDY/Y$	$P_1$	$P_2$
1979	16.3	15.5	15.5	7	8	2.33	2.21	102.0	101.9
1980	27.5	20.1	18.9	6.4	7.4	3.45	3.14	106.0	107.5
1981	18.8	17.9	9.8	4.9	6.9	4.92	3.6	102.4	102.5
1982	13	11.3	9.4	8.3	6.7	1.57	1.36	101.9	102.0
1983	19.3	15.9	10.9	9.8	6.2	1.97	1.62	102.8	102.7
1984	25.3	16.4	18.5	13.5	5.9	1.87	1.21	102.8	102.7
1985	42.6	36.9	18.9	12.3	5.2	3.46	3.0	108.8	111.9
1986	28	26	14	7.4	4.3	3.78	3.5	106.0	107.0

Sources of data: "Statistical Yearbook of China" volumes for 1981 to 1986 and "Financial Statistics Summary" (1952-1986).

From a comparison of the data in columns 1 and 2 and columns 8 and 9 of Table 3, we can see that the fluctuations of the price index are consistent with the fluctuations of cash volume  $M_0$  and money volume  $M_1$ . For columns 1 and 9, the quasi-general line model is  $P_2 = 46.2 + 0.37 (gDM_0/M_0)$  while the correlational coefficient for testing this model is  $R = 0.933$ . This shows that there is a quite close direct relationship between the staff and workers' living costs price index and the growth rates of cash and money. The quasi-general line model for columns 2 and 8 is  $P_1 = 66.63 + 0.312 (gDM_1/M_1)$  and the correlational coefficient for testing the model is  $R = 0.937$ . This shows that there is a close direct relationship of correlation between the national overall retail price index and the annual growth rate of  $M_1$ , the volume of money supply.

Column 5 of Table 3 shows the velocity of circulation of cash money  $M_0$ . When money volume supply is excessive, the logical effect on inflation is that the excessive money volumes cause the velocity of money circulation to fall. This results in a certain volume of commodities showing this increased money volume, thereby causing price rises and inflation. According to a statistical analysis of the U.S. economy by the American economist Friedman, over the period 1867 to 1960 in the United States, the velocity of money circulation has continually slowed following the development of the economy, and has seen an average annual decline of 1 percent. (Footnote 10) (Friedman: "A Monetary History of the United States 1867-1960," Princeton University Press, 1963, p 678) Professor Lin Jiken [2651 4949 5146] has also carried out a regressive analysis of the quantities of cash money circulating in our country from 1955 to 1983. He too held that there is a tendency for the velocity of

money flow to decrease following economic development, and proposed that a reduction in the following year's velocity by less than 0.088 times should be seen as the distinguishing parameter of normality. (Footnote 11) (Lin Jiken: "Several Problems in Forecasting Money Demand Quantities" in JINGJI YANJIU, 1985, No 5) From the data presented in column 5 of Table 3, we can see that it is difficult to give a normal value as a distinguishing parameter. However, in 1980, the velocity of money circulation fell by 0.6 times, in 1985 it fell by 0.7 times and in 1986 it fell by 0.9 times, and all of these were consistent with the fairly high rate of inflation in these several years.

The other observation indices which are given in columns 6 and 7 of Table 3 involve the elasticity of money supply in terms of national income. According to Baumol and Tobin's "square-root theorem," in developed countries, for each increase of 1 percent in national income, money demand volume increases by 0.5 percent. That is, the income elasticity of money demand is 0.5 percent. (Footnote 12) (Yu Raoqing [0151 7437 1987]: "Modern Monetary and Banking Studies," China Social Sciences Press, 1983) Professor Zou Zhizhuang [6760 5267 8369] has carried out calculations and analysis and holds that the income elasticity of money demand in our country over the last 30 years is 1.16. (Footnote 13) (See Fu Gangzhan [4569 4854 2069], Shi Zhengfu [0670 2973 1381], and Jin Zhongren [6855 6850 0083]: "An Analysis of Socialist Macroeconomics," Xuelin Publishing House, 1986) The regressive flexibility put forward by Comrade Liu Junshan [0491 6511 0810] was 1.4. (Footnote 14) (Liu Junshan: "The Basis for Determining Money Issue Quantities" in LIAONING SHANGZHUAN XUEBAO, 1985, No 3)



What is displayed in columns 6 and 7 of Table 3 is not ideal income elasticity of money demand, but really the actual elasticity of money supply in respect of national income. In the several years when this elasticity approached 3, the inflation rate was highest.

From the analysis above, we can see that a deep cause of our country's inflation in recent years lies in the fact that the enterprise system does not have a balance mechanism between accumulation and consumption. Such an enterprise system gives rise to growth of consumption and investment, thereby producing a gap between total demand and total supply and this is manifested, on the surface level, as an excessive issue of money and a rise in prices.

### **III. The Price Rises Subsequent to the Freeing of the Agricultural Product Markets Were the Result of Inflation, Not a Cause of Inflation**

The internal pressure for inflation is one matter, while the manifestation of inflation through particular commodity structures or particular forms is another matter. If we do not get this point clear, it will inevitably lead to mistakes in assessing some basic matters. For example, some comrades saw the phenomenon of swift price increases after the freeing of the agricultural product markets and came to the conclusion that there had been so-called cost-push inflation whereby the price of agricultural products had pushed up industrial product costs, thereby promoting inflation.

As the first part of this article noted, the contraction of enterprises' internal resources accumulation and the expansion of external resource accumulation promote the growth of staff and workers' income. This results in there being, in the hands of residents, gradually-increasing free purchasing power in excess of product supply. This is prominently manifested in the rapid growth of cash and savings in the hands of residents. The amount of savings and cash held by urban residents grew annually from 1981 to 1983 by 24.4 percent, and from 1983 to 1985, it grew annually by 37.7 percent. Of this, between 1981 and 1986, savings grew at a rate of 33 percent. However, urban residents' marginal propensity to save, as calculated on the basis of money income, saw a decline. Taking the 1982 urban residents' marginal propensity to save, as calculated on the basis of per-capita money income, as 1, by 1983 this had declined to 0.69, by 1984 it had further declined to -0.023, while in 1985 it was 0.26 and in 1986, 0.59. (Footnote 15) ("Statistical Yearbook of China" volumes for 1981, 1984 and 1986) This is a strange phenomenon. When the marginal propensity to save declines, it means that consumption expenditure has increased as a proportion of total income. If there was not excessive growth in various tangible and intangible income, the absolute total volume of savings could not grow quickly like this.

Our country's urban distribution system is a system which has welfare benefits distribution as its dominant form of distribution. Retirement insurance, medical services, housing and transport and other aspects are mainly paid for by the state, while the money expenditure of residents is restricted to the narrow commodity structure of food, clothing and utensils. The income inflation of recent years has on the one hand been manifested as a rapid growth in the money income of staff and workers and, on the other hand, it has been reflected in the expansion of and speedy growth in financial expenditure in the field of welfare distribution. Thus, the swiftly increasing free purchasing power in the hands of residents cannot but result in a clash with the gradually contracting commodity expenditure structure.

Comparing the consumption expenditure composition of our country's urban residents with the consumption expenditure composition of the residents of Japan and the FRG when their economies started to take off will make this question a little clearer. (Footnote 16) (See "World Economic Statistics Summary" (1982) and "International Economic and Social Statistical Data" (1950-1982)) First, when the per-capita national income of Japan and the FRG were equivalent to the present level in our country (about \$300-\$400), in the residents' consumption structure, housing expenditure constituted 9-16 percent, transport constituted 3-6 percent, and health care constituted above 4.5 percent. Expenditure on housing, heating, health and transport constituted over 25 percent of the residents' expenditure structure. However, in our country's present urban residents' expenditure structure, housing only constitutes 1 percent, transport costs only constitute 1.2 percent and heating and health are paid for by the state. Thus, expenditure on housing, heating, health and transport constitutes 2-3 percent of residents' expenditure. This means that the free purchasing power of residents can only be channeled into the narrow commodity structure of food, clothing and utensils. Second, in the process by which the economies of Japan and the FRG took off, the residents' expenditure structure underwent major changes. The proportions of housing and transport in the residents' consumption structure saw a conspicuous increase. From 1950 to 1977, the housing proportion in the FRG grew from 9.1 percent to 23 percent, while the transport component grew from 3.6 percent to 15.3 percent. However, the changes in the consumption structure of our country's residents from 1981 to 1986 saw a situation which went against Engels' law. The proportion of expenditure on housing fell from 1.4 percent to 1 percent, and expenditure on transport fell from 1.3 percent to 1.2 percent. Third, there were also differences in terms of the situation involving food, clothing and utensil commodities. In the food area, grain, oil, milk and bean products enjoyed financial subsidies, and prices did not move. Thus, the excessive purchasing power was channeled into commodities like vegetables and non-staple foodstuffs which had already been freed. This resulted in the prices of these commodities increasing.

In an unbalanced consumption structure and narrow expenditure structure, residents' purchasing power grows swiftly and the pressure for currency withdrawal and money absorption also grows. At the same time, the expenditure of the state and enterprises on housing, transportation, welfare benefits and subsidies increases and this then changes into increased pressure for currency withdrawal from the narrow expenditure structure. With the role of factors such as habitual collective expenditure, external demonstration of consumption and national and cultural mentalities, the course by which residents' free purchasing power enters the market, and the pounding of market commodities is not balanced. Whatever the commodities this is drawn to, they are the commodities for which there will be strong demand pressure. If there are shortages, it is inevitable that a black market will occur, while if prices are freed, the latent inflation will become a reality.

In the last few years, the daily-increasing purchasing power of residents has mainly been channeled into the purchase of commodities such as non-staple foodstuffs, domestic electric appliances and high-quality woolen clothing. This has resulted in an unprecedented demand for these commodities. Although the supply of these commodities has grown quite quickly and there has been swift industrial and investment readjustment, with the sudden whirlwind of consumption, there has been too much demand to handle. Not only has this been the case with domestic industry finding it difficult to meet demand, but even the previously regularly-used money withdrawal measures for imported durable commodities have found it difficult to cope. If we take domestic electric appliances as represented by washing machines, electric refrigerators and televisions as an example, the supply of these has grown annually by 50-90 percent since 1983, but still supply does not meet demand.

The production and consumption of agricultural and sideline products has long been carried out under the two closed systems of low-price unified purchase and unified sale by the state. The consumption rigidity of low-price distribution and sales brings increasingly heavy burdens to the financial administration and also brings increasingly serious difficulties in terms of macroeconomic balance. Finally, it pushes the state into a cycle involving "division between city and countryside—compulsory unified purchase—increased subsidies—stimulation and encouragement of waste." Thereby, the state falls into the difficult situation of "the financial administration subsidizing production and the financial administration encouraging consumption." The freeing of the markets for some agricultural and sideline products is precisely for the purpose of expanding the commodity structure, controlling consumption, reducing financial subsidies, developing interflow between the urban and rural areas and encouraging production so that the economy enters a fine cycle. Facts have proven that the freeing of markets for some agricultural and sideline products has greatly stimulated production. The supply of agricultural

and sideline products such as meat, fowl, eggs, vegetables, and fruit grew 5.2 percent in 1981 and in 1983 it grew 6.2 percent. In the years 1984 to 1986, as the markets were gradually freed, average annual growth reached above 10 percent. However, looking at this in terms of price indexes, those years in which the agricultural product supply grew most quickly were the years in which prices rose swiftly. This phenomenon whereby supply volume and prices moved in the same direction is, like the situation of domestic electric appliances and other commodities, a phenomenon which goes against market principles. This only shows that the increases in the prices of these commodities is a clash between overall growth in demand and a narrow commodity expenditure structure. Thus, the rise in agricultural commodity prices is only a form of manifestation and a result of inflation, not its cause.

In the situation whereby in 1984 the free purchasing power of residents suddenly increased, the reform of the agricultural products circulation system and the freeing of agricultural product prices in 1985 no doubt played a positive role in increasing supply and absorbing purchasing power. Thus it had an alleviating, rather than promotional, role on inflation. It can be proposed that if there had been no freeing of agricultural product prices and swift increase in production quantities, the huge free purchasing power would have put difficult-to-bear pressure on the entire market.

#### IV. Several Basic Understandings

1. In a period when various levels of the old system have already been broken through but the new system has not yet been established and thus there is a transition going on from the old to the new, it is not to be seen as strange that imbalance occurs between enterprise accumulation and consumption, or even between accumulation and consumption of the entire society, thereby giving rise to some mild inflation. The problems which occur in reform can only be resolved by the continued deepening of the reforms, and retreat is certainly not the way out.

2. The problem lies not in inflation itself, but in the understanding of the mechanisms which give rise to inflation. The understanding which held that the reform of the agricultural product circulation system gave rise to inflation turns cause and effect upside down. If such an understanding was used as the basis of decisionmaking, it would inevitably result in the agricultural product market being managed excessively tightly. This would not only not allow the problem of inflation to be solved, but would also cause economic development to take a turn for the worse.

3. If we want to eliminate the present hidden problems of inflation, first we must firmly persevere in the deep reform of the enterprise system. The stress of reform should be shifted from handing down of power and allowing the retention of profits to standardizing and

perfecting enterprises' operational mechanisms, restructuring the economic quality of accumulation and consumption within enterprises, and forming new balance mechanisms. Specifically, this means carrying out renewal in terms of the organizational system of enterprises, following the orientation of separation of the ownership and power of operation of the enterprises. In this way the operators and decisionmakers will become true carriers of the risks of decisionmaking, and this will promote the emergence of an entrepreneurial class as the representatives of the long-term development of enterprises. In turn this will form new balancing mechanism by which the property right owners, the operating decisionmakers and the staff and workers will restrict each other.

4. We must further promote the monetization of the economy, broaden the commodity markets, and form commodity market mechanisms and money absorption mechanisms which accord with the growth of residents' income. The reform of the agricultural and sideline product circulation system is the first step in expanding the commodity structure. This has played a positive role in absorbing the purchasing power which has grown too quickly, and should be continued with and persisted in. The commoditization of housing is imminent and there are other subsidized quasi-commodities which need to be truly commoditized.

5. At the same time as broadening the commodity market, we need to carry out new planning and structuring of the welfare benefits distribution system. A welfare benefit system in which the urban areas are separated from the countryside and the urban residents and completely insured is not beneficial to the monetization of the economy or modernization. Following the expansion of the differentials between residents' incomes, it will be inevitable that the universal welfare benefits system will be replaced by a social relief system. Expanding individual's decisionmaking space and the risks shouldered will be beneficial to reorganization of major factors, the raising of efficiency and the grading of consumption.

6. Our country's current inflation is not like the inflation in market economy countries which is only a monetary phenomenon, and is rather a structural phenomenon. Only by persisting in the carrying out of reform will we be able to control it, restrain it and use it to promote economic development.

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## FINANCE, BANKING

### Investment Association Calls for Reform of Investment System

40060083a Beijing JINGJIXUE ZHOUBAO in Chinese  
22 Nov 87 p 4

[Article by Jiang Lixiang [1203 4409 6116]: "Broaden Financial Markets and Reform the Investment System: The Chinese Investment Association Convenes a Theoretical Symposium"]

[Text] The second plenary meeting of the first board of directors and the second theoretical symposium of the Chinese Investment Association were jointly convened 8-12 October at Yantai, Shandong. The central topic of the conferences was the study and exploration of the characteristics of, operational patterns of and developmental strategy for China's long-term capital markets and the relationship between these markets and the reform of the investment, fiscal and financial systems.

Delegates to the conferences expressed the belief that China's capital markets are plagued with many problems, such as the price of capital, the sluggish flow of capital caused by vertical and horizontal administrative barriers, the low returns on capital and, most importantly, capital imbalances and the irrational distribution of capital. First, the amount of capital taken in by fund markets is much lower than the amount of capital these markets distribute. The excessive issue of currency and credit over the past several years is due primarily to the following four reasons: (1) Governments have overdrawn too much money from banks. (2) The state's fiscal resources cannot supply all of the fixed capital investment to which the state has committed itself, and thus the state has to make up the resulting shortfall with bank loans. (3) Authority to provide circulating funds has been granted entirely to banks, and with the state basically no longer increasing allocations of these funds, supply of these funds has greatly exceeded credit assumption capacity. (4) Bank control of credit funds has been lax, and budgetary restraints on bank credit funds have been relaxed. In addition, the direction of the flow of funds and the breakdown of the ways in which they are put to use have been irrational. In terms of indirect financial capital, the state has incorporated some of this capital into its budget to fund fixed capital credit and has thus rendered ineffective the levers and mechanisms that are controlled through credit. In terms of direct financial capital, excessive administrative interference has produced many difficulties for and greatly impeded bond issues and thus has led to net outflows of capital.

In view of the above problems, everyone attending the conferences expressed the belief that the basic way out for China's capital markets lies in promoting reform of the investment, financial, fiscal and political systems. The delegates stated that an important goal in the reform of China's economic administrative system is to gradually foster and create a complete socialist market system. Financial markets, especially long-term capital markets, form an important component of this market system, said the delegates, who delegates proposed six policies to address these issues.

First, we must demarcate the spheres of investment and carry out investment decision-making at different levels. Government investment should be applied to public utilities, infrastructural projects, national defense, aerospace, high-tech industries and a small number of key projects. Government investment projects that are national in scope should be handled by the central

government; those that are regional or local in scope should be handled by governments at the appropriate levels. Investment in general operational sectors should be borne mainly by enterprises. Once the spheres of investment are demarcated, we should appropriately decentralize investment decision-making authority and practice decision-making at various levels.

Second, we must perfect macroscopic control mechanisms by focusing on the value of capital. For government investment, we must establish a system for the funding of capital construction, use fund planning to control the total amount of this investment each year, and set investment levels according to the amount of funds the government actually controls, leaving some of these funds uncommitted in case of exigent need. For investment by enterprises (or enterprise groups), we must compute, according to fiscal and taxation policy, the investment capacities of enterprises and individuals and take these capacities into account when determining appropriate levels for total social investment. The key to effecting macroscopic control centering on the value of capital is to manage capital markets properly. We must learn and master these markets, which serve as the "switch" that controls inflows and outflows of funds, and use these markets to adjust "the flow volume" of funds so as to maintain a proper level of total social investment.

Third, we must demarcate budgetary funds and operational capital. Government investment must be funded largely through fiscal receipts and should not squeeze credit funds through administrative measures. Banks must enjoy autonomy in their use of credit funds to issue loans for investment-type purposes.

Fourth, we must establish scientific funding decision-making processes and effect a dual system of checks involving project determination and project funding. The basic way these decision-making systems would work is that we would first determine projects and then raise the capital to fund them. That is to say, we must first carry out feasibility studies of the social benefits and economic returns of potential projects and then, on the bases of these studies, decide whether or not to approve the projects for later selection. Once projects are determined through this process, the government, banks and enterprises may, under the guidance of state policy and the policy for each economic sector, select the best available projects within their investment spheres for loan grants and investment.

Fifth, we must open up direct short-term finance markets, reform the process by which these funds are handled and stress the creation and development of secondary markets. At present, the total volume of direct short-term finances is less than one-tenth of that for indirect short-term finances. To develop direct short-term financing, we must establish and perfect a macroscopic regulatory system therefor, eliminate the irrationality that besets the capital pricing system and effect

macroscopic adjustment and balancing with respect to the volume and forms in which bonds and stocks are issued. We must also establish a sound system of negotiable securities and exchanges for these securities and permit investor interests to drive the market mechanism so as to ensure that units and individuals who enter the market can derive some benefit from their investments. We must vigorously support the establishment and operation of secondary markets for securities, for the development of these markets will facilitate the growth of primary markets for securities.

Sixth, we must establish enterprise self-regulatory mechanisms. In this regard, we must first effect joint-stock management systems and truly integrate the responsibility, authority and interests of investors [text reads "meizi zhe [3093 6327 5074]; typo for touzi zhe [2121 6327 5074]]. Second, we must vigorously strengthen evaluation of investment projects, and supply loans only when we can demonstrate that projects will truly yield benefits and returns. Third, we must establish enterprise self-regulatory mechanisms so as to mobilize enterprise enthusiasm for raising their own capital, restrain enterprises from investing in low-return projects external to their own operations, gradually change the current practice associated with enterprise pre-tax loan repayment, readjust enterprise tax burdens and strengthen enterprise capitalization.

12431

**Current Inflation Causes and Cures Discussed**  
40060101 Shanghai SHIJIE JINGJI DAOBAO in  
Chinese 21 Dec 87 pp 1,3

[Article by Yang Xiaolin [2799 1420 2651]: "Establishment of a Currency Fine Tuning and Balancing Mechanism Is a Major Current Task"]

[Text] Students of financial affairs have analyzed the certain amount of inflation that has occurred since the fourth quarter of 1984 as having stemmed from multiple causes and as being curable only by using multiple means. Next year's currency tightening policies should permit a "soft landing," controlling the nominal increase in the volume of currency and avoiding major economic fluctuations.

Eradication of the country's inflation of the past several years and establishment of a currency regulatory and balancing mechanism is a major task being faced in the national economy today, and it was also the central item on the agenda of the Chinese Financial Society Currency Theory and Policy Study Conference, which was held several days ago in Wuhan. Experts at the conference explored the effects of next year's currency tightening, and proposed countermeasures.

The conference concluded that the currency situation in China during the past several years has been basically good; however, since the fourth quarter of 1984, the economy has overheated, and a certain amount of inflation has occurred. This inflation is attributable to multiple factors, including "rise in demand," "cost advance" and "structural" factors. Consequently, inflation can be eradicated only by using multiple remedies, not just through simple control of demand.

Delegates analyzed the several types of inflation existing at the present time. Inflation attributable to a rise in demand stems from total social demand being greater than total social supply. Inflation of total demand results from public finance and bank policies. Year after year government deficits have led to national income outstripping distributions, with too large a volume of bank loans being issued, and too much currency being put into circulation. The two have greatly exceeded the rate of economic growth, thereby causing inflation. Inflation attributable to cost advances has been manifested in (1) a tremendous rise in expenditures for wages that has exceeded rise in the labor productivity rate, causing an inflationary gap. (2) Large scale increases in procurement prices paid for agricultural and sideline products have brought about a rise in the costs of making light industrial manufactures and a rise in prices, even though profit levels remained fixed, giving rise to a general inflation of prices of the products of heavy industry and other goods. (3) Following the lifting of restrictions on markets dealing in the means of production, prices of raw and finished products that had formerly been held down began to rise; however, prices of processed goods, which had formerly been pushed upward, not only failed to fall but also rose along with them. Inflation of the structural type is manifested in a longstanding situation of the supply of rural sideline products in China not being equal to demand and serious underdevelopment of tertiary industries, with simultaneous supply of certain industrial goods being greater than demand. This created problems of "shortages and sluggish demand" existing side by side occasioning a natural rise in prices of goods for which supply did not meet demand, and a drop in the prices of goods for which supply was greater than demand.

As regards the reasons giving rise to the various kinds of inflation, the experts maintained that not only did the change over from the old to the new system give rise to some unavoidable problems, but two problems in currency policy also exist today as follows: (1) Longstanding lack of currency policy objectives. Whenever a conflict has existed between a stable currency and economic development, the central bank has usually selected the former and subordinated the latter. (2) Currency policy has had only annual goals. This has caused bank currency policies to change with short term economic fluctuations, making banks act in response to short term requirements. The conference maintained that next year's currency tightening policies should provide a "soft landing," should control nominal increase in the volume

of currency in circulation, and should avoid major fluctuations taking place in the economy, while the actual volume of currency in circulation should decrease as a result of a price rises to attain the goal of tightening money supply.

Tightening of the overall money supply must be accompanied by a readjustment of the national economic structure; otherwise arbitrary actions will inevitably follow, finally creating a rising spiral of inflation. Actions for tightening the money supply should follow the principle of "different approaches, and some give while tightening" as follows: Different approaches to commodity and non-commodity investment of money, and to loans for fixed assets and loans for working capital. Accompanying this dual tightening of money should be vigorous development and perfection of the bill discounting market, and an enlivening of the debentures market to provide opportunities to businesses so as to avoid restraining normal economic development. In addition, savings account interest rates should be raised, loan interest rates being raised correspondingly, to accelerate a change of consumption funds to production funds. By so doing, impetus can be given to the development of production even in a tight money climate.

Eradication of inflation once and for all requires a currency balancing and regulatory that is able both to limit the total amount of demand for funds and to regulate automatically the direction of supply of funds. The conference pointed out that industrial and commercial enterprises and banks will have to be made businesslike first of all. A beginning can be made with economic responsibility systems, going from the contracting of individual things to complete contracting. The conflict between the maximization of profits and optimized allocation of loan funds, which may occur after banks have become businesslike, may be handled by instituting control over funds for special purposes or by using a system of paying interest in the form of a deduction when selling a bill of exchange, etc. to provide loans of a policy nature. Second is perfection of the market system and a sound funds market. Financial instruments should be used to link organically direct finance capital markets and indirect finance capital markets. Once a market system has been formed, state policy interference with currency should be for the purpose of strengthening the stability of the currency in the near term. The intermediate term objective should be both to control the basic currency and the supply of currency, and to use administrative methods as necessary to control the total size of loan funds. Methods for controlling the supply of money at the present stage should be of many kinds and comprehensive. In particular, the role of interest rates should be used to advantage, and distinctions should be made between soft budget restricted and hard budget restricted businesses, projects within plan and outside of plan, and differences in interest rates for parity price and negotiated price commodities. In addition, the planning, public finance, investment and financial systems should be thoroughly reformed. This correlates most closely

with the formation of a currency balancing and regulatory mechanism in which automatic market regulation and state plan regulation are linked.

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### **Direction of Financial Reform Discussed**

40060058 Beijing CAIMAO JINGJI [FINANCE AND TRADE ECONOMICS] in Chinese  
No 9, 11 Sep 87 pp 9-13

[Article by Wang Shaofei [3769 4801 7378] of the Institute of Finance, Commerce, and Commodities Economics at the Chinese Academy of Social Sciences: "The Direction of a More Intense Financial Reform Process"]

[Text] In recent years, reform of the financial system has moved to the forefront of urban economic reform. Financial reform has had positive effects on urban economic reforms, especially in areas of enhancing the financial power of enterprises and their right of self-determination. The reform has moved in the right direction, and results have been excellent. Today, in order to implement further and more thorough financial reform, we must better understand the need to move forward, as well as the direction we should be heading. In the past, reforms concentrated on eradicating rigid government control over revenue and expenditure, at reducing taxes and profit appropriations, and at delegating financial authority to generate a better environment for enlivening enterprises. These kind of reforms are drawing to a close. However the devolution of financial power is incomplete, tax rates need further adjustment, the adjustment tax needs to be abolished gradually, and the tax burden of large and medium-sized enterprises needs to be further lightened. Overall, we cannot ask the government to substantially reduce taxes and profit appropriations. Instead, the way to carry the reform process further is to create a new financial system which best suits the conditions in this country.

#### **A. Establish An Interacting Mechanism Between Public Finance and Banking**

Under the old system where planning and public finance were highly centralized, the country relied on the principle of unified allocation and appropriation to balance government revenue and expenditure and bank credit. Public expenditures guaranteed capital construction investments while bank credits guaranteed the supply of enterprise circulating funds. To the enterprises, public financed investments and bank loans were no different; both were government funds. The Ministry of Finance and the banks also regarded themselves as all in the family, on matters of property rights or leadership. As far as the highest decisionmaking organ was concerned, the Ministry of Finance and the banks were institutions which supply funds; they shared the duty of guaranteeing the supply of funds. It was necessary to commingle state revenue and expenditure with bank credit to facilitate

calculation of total availability of funds. This traditional concept of treating public finance and banking as one family still persists, and is the main obstacle in the creation of a macroeconomic mechanism which bridges public finance and banking. This concept causes some people to become confused about the inherent economic duties of public finance and banking; they become overly concerned with seizing power and broadening their sphere of influence; they want to insure that their own department has greater influence, power, and status in making macroeconomic decisions. As a result, macroeconomic policies are out of control, fostering a sense of arbitrariness. In recent years, there has been much debate over which should play a bigger role, public finance or banking. This is a dispute over the scope of administrative power and not a matter of the inherent economic duties of public finance and banking. The idea of a bigger role for public finance and a smaller role for banking is to reduce the economic duties of the banks, and subjugate their credit policies to the government budget, and make issuing currency the means to balance the budget. Conversely, a bigger role for banking and a smaller role for public finance is to cut down the scope of government allocations, and let bank credit replace some fiscal revenue and expenditure. The government would no longer decide what goods and materials to produce, and the buying and selling of funds would replace government allocations. The author feels that these ideas have no scientific basis. The scope of public finance and bank credit is not a subjective matter, and their inherent economic duties are not interchangeable. To augment public finance and reduce the role of banking, or vice versa, will disrupt the boundary between these entities, and upset the workings of the economy. The financial deficits and bloated bank credits in recent years are largely due to the expansionist policies initiated by the Ministry of Finance and the banks to enlarge their respective sphere of influence. This kind of expansionism identifies with the guiding principle which emphasizes short-term profits and immediate gratification in macroeconomic decisions, and has gained tremendous ground in recent years: between 1984 and 1987, government budget deficits and bank credit shortfalls have increased every year. For example, the budget deficit, excluding income from borrowing, was 12.18 billion yuan in 1984, 6.82 billionyuan in 1985, 20.88 billion yuan in 1986, and estimated to be 28.6 billion yuan in 1987. Bank credit shortfall\* was 33.2 billion yuan in 1984, 28.3 billion yuan in 1985, 48.3 billion yuan in 1986, and the 1987 figure is difficult to forecast at this time. [Bank credit shortfall includes bank deposits plus the amount of increase in banks' own funds minus the amount of increase in loans; it does not include the issuance of currency] The central bank had to issue currency eventually to make up for the financial deficit and the bank credit shortfall. Table 1 below shows the amount of overdraft, bank credit shortfall, and newly issued currency (unit: 100 million yuan):

Table 1

Year	Year's Deficit Financing by Bank Overdraft	Year's Bank Credit Shortfall	Year's Newly Issued Currency
1981	-	+34	50
1982	-	+8	43
1983	30	+40	91
1984	61	-332	262
1985	14	-283	196
1986	95	-483	231

The numbers reflect the government revenue and expenditure, bank credit, and additional amount of currency issued in each year. The three elements are distinct but interrelated. These are three different kinds of deficits. If we use the tradition, "eating out of the same big pot," method of balancing these deficits on one balance sheet, the figures will appear as in Table 2 below:

Table 2

Year	Increase in Credit Fund Sources	Increase in Credit Fund Utilization	Additional Currency Issued
1981	401	451	50
1982	372	415	43
1983	385	476	91
1984	852	1,114	262
1985	615	811	196
1986	1,546	1,777	231

This simple balance sheet shows the budget deficit, enterprise investment shortfall, and bank credit shortfall. Balance is obtained by the following process: budget deficit is funded by bank overdraft; enterprise investments are not funded through bank loans, and bank credit shortfall is remedied by issuing currency through the central bank. Issuing more currency is the principal means to raise investment volume and realize balanced credit. This practice of issuing currency to feed public finance and the credit system in order to achieve balance is the major flaw in the present financial and banking systems, and is also the major cause for the excessive investment in fixed assets. Further reform should not move in the direction of augmenting public finance and diminishing the role of the banks by subjugating banking to financial policies, nor should we augment the banks and cut down the role of public finance by reducing the scope of allocations. In the future we must follow the natural course of the commodity economy. First, clearly draw the boundaries between public finance, credit, and money supply. End the practice of "eating out of the same big pot," and set up "separate housekeeping." Public finance, credit, and money supply must be managed individually and balanced individually, but build a relationship base on their individuality so that they act

upon one another, and together they restrain investments and reduce the arbitrariness in investment decisions, and curb the vice of issuing currency to finance vast fixed-asset investments. Therefore:

1. Reform the relationship between public finance and central banking, and eradicate the age-old vice of public finance pressuring banks and banks exploiting public finance, and establish an effective mechanism which allows interaction between the two entities. First, based on the principle that one must have the money before spending it, the central bank must restrain the government budget, and refuse payment if the government has insufficient revenue, or no revenue. The government must follow procedure and apply for bank loans, or issue treasury bonds, to finance budget deficits. The central bank must refuse government overdraft. When the government borrows money to pay for deficits, the banks should charge interest at a rate no lower than the interest on shortterm bonds. Because the financial ministry and the central bank have the deep-rooted habit of "eating out of the same big pot," they often will not or cannot function, but are inclined to interfere with the each other's duties, and antagonize each other; therefore, in formulating further and more thorough financial reforms, we should consider separating the Treasury and the central bank. Establish a financial bank which specializes in the handling of government revenue and expenditure as well as public debts. Stop commingling government revenue and expenditure with currency issues, and turn the central bank into a bonafide bank of issue. Prevent the government budget from interfering with the issuing of currency, and draw a clear boundary between government deficit and inflation. Define the economic roles of public finance and central banking, and give the central bank full legal responsibility to issue currency. At the same time, remove the central bank from the government, and place it directly under the National People's Congress, to shun interference from the various administrative organs, and enable the bank to properly carry out its currency issuing duty. The central bank should become a macroeconomic control institution outside of the government, free from the influence of government budget and overall investment decisions. Secondly, because currency issues must comply with the need to maintain constant and steady economic growth, the government must exercise macro control over the central bank, and levy a tax on currency issues. Such tax may be exempt or reduced if currency is issued to meet the needs of normal economic development, but issues in excess of normal needs will be taxed at a progressive rate, up to 90 percent if necessary, to effectively halt inflation. At the same time, the additional currency should be treated as national income so that the central bank cannot directly benefit from the currency issues and cause instability in the money supply. Substantially raise the salaries of the central bank employees, and abolish the bonus system, because the central bank's bonus, if linked to any economic indicator, inevitably causes artificial instability in currency circulation, and adversely affects the economy at the



macro level. The degree of stability in currency circulation is the only standard for evaluating the performance of the central bank.

2. Reform the relationship between public finance and bank credits. In a commodity economy, funds become a commodity, and government revenue and expenditure must directly interact with the buying and selling of funds. Public debt becomes a component in the government budget and interacts with bank credit. Government borrowing and bank credit are the buying and selling of the right to use funds, and they are directly associated with the people's savings and enterprise's temporary idle funds. Government borrowing is the gathering of funds in society either through bond issues or direct loans, and interests are paid to the purchasers of bonds or to banks extending the loans. Banks are the intermediaries in the lending and borrowing relationship; they act as lenders and borrowers: as borrowers, they pay interest to the lenders (interest on deposits,) and as lenders, they collect interest from the borrowers (interest on loans.) However, whether it is public debt or bank credit, both are constrained by the total amount of funds in circulation. Because society only has a fixed amount of funds in circulation, public debt and bank credit are mutually exclusive: if government borrowing increases, the source of bank credit funds will decrease, and vice versa. It is not like what some people think, that society has unlimited source of funds, that banks have the ability to create funds and make something out of nothing. Certain macroeconomic decision can sever the cord between bank credit and currency issues, and free the specialized banks and the central bank from the bondage of the administrative organs; then the bank's ability to create funds will disappear, and credits will immediately feel the crunch of the limited funds, and the conflict between government borrowing and bank credit will become obvious. Therefore, restructuring the relationship between government borrowing and bank credit crucial to the restructuring of the financial system. Reforms should follow the course of: first, balance the scope of government borrowing and bank credit. Bank credit must consider treasury bond issues and government borrowing as a part of the overall credit plan, and consider the amount of funds government borrowing might absorb, and reduce its credit volume accordingly. The government must consider what bank credits need, and must not increase government borrowing indefinitely. Secondly, in order to properly handle the relationship between government borrowing and bank credit, the ministry of finance should set up a specialized organ to manage the gathering and utilization of borrowed funds, and participate in fund market activities, and put the fiscal income and expenditure on the same track as the commodity economy, so that public finance can meet the needs of the development of the commodity economy.

3. Encourage the specialized banks to become more enterprise-like. The ministry of finance must treat specialized banks the same way it treats industrial and commercial enterprises in general, and levy similar taxes

on them. Specialized banks are commercial enterprises in the monetary funds business; they should not be administered to by the central bank, nor should they monopolize the supply of enterprise circulating funds. We must change the traditional system of fund allocation, and eradicate the vice of "eating out of the same big pot," and indulge public finance and bank credit by issuing currency. This is the key link in the reform of the financial and banking systems and in enhancing macro-economic control.

#### **B. Intensify Financial Restraints, Encourage Enterprises To Be Responsible For Their Profits And Losses**

The central link in economic reforms is to enliven enterprises, especially the large and mid-sized state-run enterprises, and financial reforms effect this goal by creating the right conditions. On the one hand, we must restructure the allocation relationship between government and enterprises to enable enterprises to accumulate, reform, and develop on their own. On the other hand, we must radically change the way the government manages the enterprises, and end the enterprises' dependence on the government. Intensify the financial restraint on enterprises, and use the financial system to make them take responsibility for their own profits and losses. In the last few years, reforms have emphasized tax reduction and lower profit remittance, to give enterprises more financial control, and enable them to initiate and finance their own expansion. After several year's reforms, besides basic depreciation funds which are entirely controlled by enterprises, enterprise's actual retained profit (including pre-tax loan repayments) is almost 50 percent of the realized profit. Financial reform should now turn to intensifying the financial restraint on enterprises to improve economic result, and encourage them to use their present financial means to assume economic responsibility for themselves.

1. Strengthen the tax system. The present tax system is scattered, chaotic, and lax, and fails to restrain enterprises. The system is scattered in the sense the power of taxation is not centralized, and the tax bureaux cannot act independently but are controlled by the various central and local administrative departments. The system is chaotic because there is no unified tax law, and tax categories are arbitrary. The system is lax in the sense tax fraud and tax evasion are common among enterprises, and governments at all levels can reduce or exempt tax at will; in fact they have broad power to reduce or exempt tax. For example, new products and new technologies, shops which hire young intellectuals, export commodities, foreign funded enterprises and Chinese-foreign joint ventures, lateral economic ties, township enterprises, sideline and agricultural products, investments from abroad, and enterprises which suffer losses are all entitled to tax reduction or exemption, and there are other reductions and exemptions approved by the heads of various departments at all levels. If adjustment tax fails to help the enterprise, income tax is reduced, and if that is not sufficient, circulation tax is cut, and so on, until all



taxes are reduced or exempt, and if that is not enough, the government even subsidizes the enterprise. This kind of tax system fails to give enterprises the economic incentive to operate more efficiently and increase profit. On the contrary, it only induces them to ask for endless tax breaks, and weakens their will to struggle for success and improvement. Therefore, tightening the tax constraint is a necessary measure to make the enterprises more self-reliant. The way to tighten the tax constraint is to thoroughly reform the system, refine the tax categories, adjust tax rates, and standardize and legalize the system.

2. Gradually abolish the subsidies for unprofitable enterprises. To turn enterprises into independent, or relatively independent, businesses and producers of commodities, and turn them into independent economic entities responsible for their own profits and losses, and able to survive in a competitive market, the government must stop running the show for enterprises, and stop taking economic responsibilities for their operation. Instead, it must be prepared to gradually abolish the subsidies for unprofitable enterprises. When an enterprise loses money due to mismanagement, it should declare bankruptcy in accordance with the bankruptcy law. The government should freeze the asset of a bankrupt enterprise, and re-evaluate its assets, and salvage the investment. Investments which cannot be salvaged should be written off, together with the bankrupt enterprise, and the loss absorbed. Products which must continued to be produced but are unprofitable due to economic or technical reasons should be given price support through government allocations, but not in the form of loss subsidy. This will encourage enterprises to improve their management and operation, and gradually take economic responsibility for themselves. If we retain the subsidy system, we will never see enterprises take responsibility for themselves, nor will they declare bankruptcy when they failed.

3. As enterprises begin to accumulate their own resources, and initiate and support their own reform and development, we must change the structure of public spending, and transfer to enterprises investments which should be financed by them. For example, cost of trial-production of new products, tapping potentialities, transformation, technological renewal, expansion, and other investments should be financed by enterprises themselves, and the government should not make further investments. At the same time, some social expenses presently paid for by enterprises, such as public facilities, social services, and other essential social appropriations and allocations, should be financed publicly to reduce the enterprises' social burden, and better enable them to become independent and responsible for their own profits and losses.

4. Promptly disallow the treatment of loan-repayment as a pre-tax item, and turn it into an after-tax item. Based on the principle of self-determination and enterprise economic responsibility, enterprises must pay off their own loans and not rely on the government. Pre-tax loan

repayment in fact is using tax revenues to fund investments; it not only constitutes unauthorized outlay of receipts, but is making profit out of other people's money. Regardless of how the investments turn out, they reduce future government revenues at no loss to enterprises, therefore they will continue to borrow funds and over-invest, causing excess allocation of national income. To make enterprises more concerned with investment performance, instead of pre-tax loan repayment, loans should be paid out of the profit retained by enterprises. This will control the bloated investment and consumption funds, and will have significant effects on promoting steady economic growth.

### **C. Gradually Make Possible the Implementation of A Graded Public Finance System**

In this vast and economically unbalanced nation, a highly centralized system of financial management inevitably will produce many negative effects, and rob society of its economic vitality. We must appropriately divide the financial power between the central and the local governments, and implement a graded public finance system, to suit measures to local conditions, and promote balanced local economic developments. The present "separate housekeeping" type of financial system eliminates the traditional unified appropriation and allocation, and follows the basic principle of separate management levels, but it is far from being a genuine graded public finance system. The "separate housekeeping" system entails a unified budget; the scope of the budget is determined centrally by the central government, and local governments abide by the budget handed down from above, and manage the applicable expenses, and raise local revenues. Out of the total local revenue, the local governments retain the portion to be spent according to the budget, and turn over the rest to the higher authority which must make up for any shortfall. A graded financial system is based on separate budgets for separate levels: local governments plan their expenditure based on their source of revenue, and must rely on themselves to balance the budget. Each level's budget is independent, and there is no direct relationship between the budget of the central government and that of the local governments. Therefore, further financial reforms should facilitate the transition from the "separate housekeeping" system to a graded public finance system. The necessary conditions are:

1. In the wake of developments in economic and political reforms, clearly define the scope of the authority of the central government and the various levels of local government, especially their economic rights and duties. This is the precondition for a graded public finance system. For many years, our financial reforms swing back and forth because we have failed to define the function and power of the central and local governments, especially their economic rights and duties; we have not clearly separate administrative and economic constructions. As a result, the central government and local governments take up similar projects; they get into each

other's way, and make things difficult for each other; investments and constructions are duplicated; financial resources are scattered; necessary projects are not undertaken, and money is wasted on unnecessary projects. These incidents, to a large extent, have adversely affected the balanced economic growth locally as well as nationally. Often we sway between centralizing and dispersing financial power; we waver between tightening control and relaxing control; we cannot maintain a steady progress. A graded financial system links financial power to job responsibility, and guarantees each level of government sufficient financial means to fulfill its tasks. However, defining each level of government's authority involves political reforms, and is rather complicated. On the one hand, this is a vast country with a huge population and weak economic basis; some parts of the country are better developed than others; without sufficient local support, leaving the central government in charge of everything is not likely to produce good results. On the other hand, this country has a long feudal tradition, and too much local power can easily give rise to regionalism and rejection of central directions — history has repeatedly taught us this lesson. Historically, China was strongest in periods when power was centralized. From the point of a commodity economy, regionalism limits product circulation and obstructs the formation of a unified market, and has negative effects on the development of the economy. Regionalism is especially incompatible with the economies of scale. Therefore, while we want some separation, we must avoid disintegration which gives rise to regionalism, and we need centralization but not over-concentration which dampens local enthusiasm, and hinders the development of the productive force. Therefore, the key to implementing a graded financial system, or even restructuring the political system, lies in finding the way to define central and local prerogative, especially the scope of their economic rights and duties.

2. Gradually implement a classified tax system. Classified taxation is the prerequisite to a graded public finance system. Without a classified tax system, local areas are without an independent source of income; it will be impossible for them to have independent finances, and it will be impossible to stop the central and local governments from pooling their revenues, and "eat out of the same big pot." The present "separate housekeeping" system clearly demonstrated this point. This system uses local financial outlays over the years as basing point to determine how much revenue the local government gets, and divides the present tax revenues into three parts: central tax (central government revenue), local tax (local fixed revenue), and shared revenue (proportionally divided between the central and local governments.) This is not really a classified tax system. Classified tax system is not dividing present tax categories into central or local taxes; rather, it is to establish two sets of tax systems, one for the central government, and one for local governments, so that local governments can enact independent tax laws. The central tax is legislated by the central government, and local taxes are legislated locally.

Naturally, some taxes such as tariffs and product taxes should be levied by the central government, not local governments. Other taxes such as transactions tax, slaughtering tax, real-estate taxes and so on are local taxes, and should not be levied by the central government. Taxes such as income tax may be levied by the central and local governments, separately. Under the classified tax system, central tax revenues and local tax revenues are separate entities under separate jurisdiction, and any tax reduction or exemption must be approved by the proper authorities.

3. Establish separate budget levels. The graded public finance system is characterized by separate budget levels. This means the budget of every level is relatively independent. Each level's budget reflects its own fiscal revenue and expenditure, and each level must balance its own budget. If a lower level government runs into a budget deficit, and needs to borrowing money from the bank or from a higher authority, it must repay all loans as scheduled. Under the graded public finance system, subsidies handed down from a higher level government to a lower level government should be treated as an expenditure and not as an unauthorized outlay of receipts; the recipient of such subsidy must declare it as revenue, and not as profit remitted by the higher authority.

Under the graded public finance system, the national budget takes two different forms: one budget determines the scope of revenue and expenditure at each government level; this must be ratified by the legislative organ at each level before it becomes legal. The other is a total budget which the ministry of finance pools from the budget of all levels, and this is the country's comprehensive financial plan. It reflects society's total stock and flow of fiscal revenue and expenditure, and is what the country bases itself on when implementing macroeconomic control. These two kinds of budget serve different purposes. Under the present financial system, because central and local revenues and expenditure are still "eating out of the same big pot," it is impossible to separate the two budgets. Instead, we ended up making a distinction between budgetary and extra-budget revenues. This distinction is the product of "eating out of the same big pot" in public finance. When the graded public finance system is implemented, such distinction will no longer exist. The budget of each level will include all of its revenue, and enterprises which are first-level budget units will include all their income. Therefore, this kind of separate budget, in sum, is also a kind of unified budget; it reinforces macroeconomic control of public finance, but there is no crowding out, and it does not cause equalitarianism and indiscriminate transfer of funds, and budgetary and extra-budget income will become meaningless terms.

**Suggestions on Financing Commodity Housing**  
40060074 Beijing JINRONG SHIBAO in Chinese  
9 Nov 87 p 3

[Article by Ma Mingjia [7456 7686 1367]: "Financial Reforms in Support of Housing Commercialization"]

[Text] The commercialization of housing calls for corresponding reforms in the financing system. I think now is the time to institute the following financial reforms.

**1. Establishment of Home Financing Institutions**

The objective of urban housing reform is to turn real estate distribution into money distribution and put homes on the consumer market. To achieve this, it is necessary to have the right kind of financial institutions to raise funds, make loans, and settle accounts. Yet, in China today, there is no financial institution which specializes in serving the reform of the housing system, and the need for change is obvious. In the light of China's conditions and drawing on the experience of other countries, consideration should be given to establishing the following three types of financial organizations. First, the establishment of home loan departments. All qualified banks, particularly the industrial and commercial banks and construction banks which are closely related to urban housing reform, can set up home loan departments to handle loans and settle accounts for units and individuals to buy or build houses. Second, the establishment of housing construction savings associations. Large and medium-sized enterprises in cities where housing reforms are being carried out on an experimental basis can set up housing construction savings associations on the principle of voluntary participation. Membership to the associations should be limited to each company's own workers and staff members. The savings deposits accumulated can be used as housing loans for members or to augment the enterprises' housing construction funds. Association members have priority in buying new homes built by their companies and may even get some company subsidies. Third, the establishment of home savings banks on a trial basis. Pilot home savings banks can be set up in one or two cities where experiments are being made in reforming the housing system to gain experience. These banks can be capitalized by shares subscribed by local governments, specialized banks, insurance companies, enterprises, and establishments. They should operate under the guidance and control of the People's Bank of China, and each should have a board of directors, under which the president assumes full responsibility. The banks should operate on the principle of secured principal and low interest and should not make profit their goal. They should insist on "independent management, assuming full responsibility for their own profit or loss, taking their own risks, and achieving their own balances." They should concentrate on the real-estate loan business and devote themselves to serving the local urban housing reform.

**2. Readjustment of the Bank Credit Structure**

Urban housing reform cannot succeed without the availability of bank credit. Although China's banks today have a surplus of several hundred billion yuan in deposits over loans, little of the money is used on housing, as most of it is used by enterprises as working funds or for technological renovations. To change this situation, readjustments must be made to the bank credit structure. Consideration should be given to reducing a certain percentage from the technological renovation loans extended to enterprises, or setting aside a portion of new savings deposits, or both, and the funds thus made available can be used to support the housing reform.

**3. Opening New Fund-raising Channels**

Although readjustment of the bank credit structure can provide some funds for housing, the amount will be limited. The fundamental solution lies in applying diversified credit means to open up new fund-raising channels. At present, the following four channels seem feasible. First, the establishment of housing funds. The scattered funds set aside for housing by various departments and units can be pooled together and used specifically as housing loans in an orderly way. Second, the opening of home savings accounts. The specialized banks, home loan departments, and pilot home savings banks should all actively promote this type of savings deposits. The principle of "linking loans to deposits, limiting loans to depositors, attracting deposits with loans, and building up loan funds with deposits" must be followed so that the organic combination of deposits and loans can attract more people to save for homes and alleviate the pressure on bank credit. If necessary, we can draw on the experience of the Philippines, Brazil, Mexico, France, and other countries in making it compulsory for workers and staff members with higher wages and lighter family burdens to deposit a specific percentage of their wages in home savings accounts. Third, the floating of housing bonds. Specialized banks and home savings banks in cities designated for experimental housing reforms can issue housing bonds to local units and individuals with the approval of the People's Bank of China. Bond holders urgently in need of cash can obtain bank loans using the bonds as collateral, and they can also sell their bonds through banks or directly in the securities market. Fourth, advance payments for homes. Builders should be encouraged to negotiate an agreement with prospective home buyers to have 50-70 percent of the cost of the homes to be built paid in advance. Even though this practice does not increase the funds raised by the banks, it will put the available housing funds to more effective use and speed up the construction of new homes.

**4. Institution of Home Mortgage Loans**

Residential housing loans are different from loans extended to industrial and commercial enterprises. Housing loans not only tie up funds for longer periods,

but involve more borrowers and greater risks. Therefore, unlike loans to enterprises, which are usually extended on credit, residential housing loans will have to be secured. To obtain a mortgage loan, the borrower should surrender the title deed of the home he buys to the bank as security according to provisions in the loan agreement, and will get it back upon repayment of principal and interest. If the borrower fails to repay principal and interest when due, the bank has the right to put the mortgaged house on sale and recover the principal and interest due from the proceeds. In this way, the banks can extend housing loans to residents and support the housing reform without fear of loss. At the same time, it will strengthen the borrowers' sense of credit, make them repay loans on time, and bring about a sound circulation of credit funds.

12802/9604

### Price Subsidies Discussed

40060076 Beijing CAIZHENG YANJIU [THE FISCAL SCIENCE] in Chinese No 10, 28 Oct 87 pp 32-36

[Article by Xiang Jingquan [7309 6975 3123] and Yang Liangchu [2799 5328 0443]: "China's Current Price Subsidies, Their Origin, and Suggestions for Dealing with Them"]

[Text] A. Price subsidies are an important economic lever by which the state coordinates economic activity and regulates the distribution and redistribution of national income according to its policy needs. Since the Third Plenary Session of the Eleventh Party Congress, China's economy has tended to grow harmoniously and living standards have improved considerably, due essentially to the results of implementation by the Party and the state of a series of programs and policies, an inextricable component of which was the regulatory role played by price subsidies.

1. They have promoted development of agricultural production. By implementing inverted linkage for purchase and sale prices and expending large sums in price subsidies, the state significantly raised purchase prices for agricultural and sideline products and greatly mobilized peasant enthusiasm for production. According to statistics, purchase prices for agricultural and sideline products rose 72 percent from 1986 to 1987. From 1979 to 1986, total price subsidies for agricultural and sideline products amounted to more than 180 billion yuan. At the same time, the means of agricultural production such as fertilizers and farm chemicals, diesel oil, electricity, machinery, plastic sheeting, etc., provided to villages at low prices greatly improved agricultural production conditions and led to increased productivity. According to statistics, from 1979 to 1986, state subsidies going directly to agricultural means of production reached more than 12 billion yuan. In addition, thoroughgoing reforms of productive relationships in agriculture and the impact of such factors as the development of agrotechnology led to overall development of agriculture,

forestry, animal husbandry, sidelines, and fishery. From 1978 to 1986, gross agricultural output value increased 150 percent; the increase for crop-growing was about 100 percent, for forestry about 200 percent, for animal husbandry about 150 percent, for fishery 250 percent, and for sidelines, about 400 percent. In crop-growing, grain output increased by 28.3 percent, and cotton increased by 61.2 percent.

2. They have promoted development of industrial production. According to statistics, from 1979 to 1986 subsidies from the state's financial departments to industrial production amounted to more than 98 billion yuan. This ensured that the people's everyday needs for manufactured goods for everyday use were met, stabilized markets and prices for those goods, and had an important stimulating effect.

3. They have stabilized and improved urban and rural living standards. According to statistics, from 1979 to 1986 price subsidies for urban residents amounted to more than 172 billion yuan, and more than 47 billion yuan. During the Sixth 5-Year Plan alone, urban residents benefited by an average of 182 yuan through inverse linkage for purchase and sale prices for grain, oils, nonstaple foodstuffs, and cotton wadding and manufactured goods for everyday use; rural residents benefited by an average of 156 yuan through preferential policies and subsidies, including 69 yuan in direct benefits, accounting for 39.4 percent of the increase in peasant net income for that period.

4. They supported the development of foreign trade. According to statistics, from 1979 to 1986 the state, in order to bring in technology and equipment and balance domestic supply and demand, gave more than 34 billion yuan in subsidies for imported machinery and equipment for grain, placer mining, fertilizers and farm chemicals, cotton, etc. This played an important role in developing Chinese import and export trade.

B. The positive effects of price subsidies are achieved under certain quantitative conditions; exceeding quantitative limits may have a negative impact.

In recent years, China's price subsidies have increased steadily, and their scope has expanded daily, exposing their drawbacks and risks more clearly every day:

1. Price subsidies take up an ever-growing proportion of the state's financial income and are becoming a heavy financial burden for the state. In recent years the increase in price subsidies has exceeded the capacity of the state's financial departments to support them. The increase in price subsidies has surpassed the rate of increase in financial income. In 1978, price subsidies amounted to 9.38 billion yuan; in 1985 this had increased to more than 30 billion yuan, a 220 percent increase, while during the same period financial income rose by only 60 percent. Price subsidies account for an excessive proportion of financial income. From 1979 to

1986 the price subsidies borne by the financial departments corresponded to one-fourth of financial income during the same period, causing problems for the state's financial balance and a deficit of 50 billion yuan for that period.

2. The swollen scope of price subsidies has weakened the financial departments' macroeconomic regulating capability. According to figures from the relevant departments, from 1979 to 1986 expenditures by state financial departments for all subsidies, including price subsidies, plus more than 100 billion yuan annually in nonproductive financial expenditures, left few funds for the state to spend on economic construction. From 1979 to 1986, state funds allocated to economic construction increased by only 13 billion yuan, or 22.5 percent, which was far below the increase in financial income during the same period. This had a great impact on the state's ability to invest in economic development and affected the economy's reserve strength and promotion of economic system reform.

3. Subsidies are not helpful in mobilizing enthusiasm for production and operations in grain- and cotton-growing regions, nor do they promote normal circulation of agricultural and sideline products. These excessive price subsidies are actually an administrative approach that limits the role of the law of value, objectively restricts the regulatory effect of market mechanisms on the supply and demand of agricultural and sideline products, and has a whole series of negative impacts on the production and circulation of agricultural products. For example, under the current policy of subsidies for agricultural and sideline products, the regions growing more cotton and grain get more price subsidies, increasing the burden on the financial departments; on the surface of it, these subsidies would seem to help support grain and cotton production, but in fact they affect inputs and services in grain and cotton production in these regions, to a certain extent dampening peasant enthusiasm for planting grain and cotton. As another example, under the current policy of price subsidies, departments enthusiastically launching grain, cotton, and oil-crop operations suffer greater losses, becoming "key loss-control households," while departments engaging in fewer such operations suffer fewer losses and are praised for this, which dampens the enthusiasm of grain, cotton, and oil-crop enterprises. Furthermore, because of the current jumble of types of price subsidies, some commercial departments and enterprises circumvent the price subsidy system by converting parity prices to negotiated prices, and vice versa, engaging in illegal and undisciplined behavior in obtaining state subsidies. Moreover, the inverted linkage of purchase and sale prices for grain means that nonnegotiable securities imply state price subsidies for planned grain purchases and sales, causing the state to give 1 jiao in subsidies for every jin of grain sold under the plans. According to incomplete statistics, approximately 20 percent of the grain coupons issued by the state are used as a "second currency" on the black market, with the state losing several hundred million yuan in funds annually because of this.

4. Price subsidies conceal true parity between different commodities, hindering improvements in enterprise management as well as equal competition among enterprises. Price subsidies are a means of compensating for prices deviating from value. If price subsidies are relied on without restriction for a long time, the deviation of prices from value may become long-term and fixed, concealing the actual cost and value of the subsidized commodities as well as price parities among commodities. For example, if the selling price of grain is lower than its value, and grain is exchanged for commodities whose price is approximately equal to their value, grain production and operations will suffer losses. These irrational rates of exchange not only affect the production of and transactions in subsidized commodities, they may also cause those commodities to be wasted. In recent years the scope of price subsidies has been steadily expanding, with more and more commodities subject to multiple prices; this increasingly irrational price system causes enterprises benefiting from subsidies to become complacent, so that they lack enthusiasm for improving their management. At the same time, excessive price subsidies have impaired the accuracy of accounting and served to cover up poor management, making it impossible to correctly assess operating results and management quality and to achieve equal competition.

C. The expanding scope of price subsidies raises the problem of macroeconomic policies being uncoordinated and incomplete, and that of price subsidy management. Specifically, these problems are due to the following:

1. An unstable agricultural foundation is the primary reason for the steady increase in price subsidies. The large increase in China's price subsidies for grain, etc., began in the early 1960's, and mistakes in the Great Leap Forward caused a severe drop in agricultural output. In order to stimulate rapid recovery and development of agriculture, subsidies were increased through such measures as markups for extrapurchases, at the same time as the purchase prices for grain and other agricultural products were raised by a wide margin. After several years of readjustment and a turn for the better in the agricultural situation, price subsidies were reduced to almost nothing by eliminating such measures as markups for excess purchases and higher purchase prices. The large increase in price subsidies since 1979 was also a measure taken to reverse the agricultural backsliding caused by 10 years of chaos. However, these price subsidies were extended beyond the 1960's, their scope increasing steadily, primarily because of unstable agriculture. For example, in 1985 grain output declined by more than 50 billion jin from 1984; although production rose by 20 billion jin in 1986, more than 20 billion additional jin were imported. This was because of inadequate estimates of the grain situation and because readjustments in industrial structure were not solidly founded on agriculture, and particularly grain. Hence there was a major decline in the area sown in grain, more than 60 million mu in 1985 alone. At the same time,

there was a huge reduction in the rural grain-sowing labor force, with many able-bodied workers going out to engage in business, transport, and construction, causing total and unit grain production to decline considerably.

2. Overall coordination and balancing of the economy have not kept up. For example, when prices were raised, no thought was given to the ability of the financial departments, enterprises, and the people to bear them, and the pace of these raises was too fast. As another example, in 1985 meat and vegetable prices were decontrolled; hidden subsidies were changed to overt subsidies, in order to reduce some subsidies. However, because insufficient thought was given to the timing and means of decontrol, the result was that hidden subsidies were not reduced, and overt subsidies increased by several billion yuan.

3. Management of price subsidies was lax. For example, the scope of price subsidies was expanded from grain, cotton, oils, and other essentials to meat, eggs, vegetables, poultry, aquatic products, soap, and fruit. According to statistics, the number of different price subsidies borne by the central financial departments rose to 47, and another 120-plus were borne by local financial departments. Price subsidies were so varied in form that a single commodity might have several different types of subsidies; grain and oil products, for example, had price-difference subsidies, extra-purchase markup subsidies, subsidies for operating losses, subsidies for conversion from negotiated prices to parity prices. The range and complexity of price subsidies not only led to many loopholes in those subsidies but also unnecessarily increased the burden on financial departments. As another example, authority over price subsidies is so scattered that many local governments make their own determinations as to increasing types of subsidies, expanding their scope, applying price hikes or nonprice subsidies, and returning profits according to local needs, so that the subsidy door is opened wider and wider. Moreover, the price subsidy approach is one of reimbursement for what is spent, so that it is unable to promote improved management in operating units.

D. Solving the price subsidy problem requires improving the coordination of national macroeconomic policies and the management of price subsidies.

1. We must take radical measures to firmly establish the concept that "agriculture is the foundation of the national economy" and strive to raise productivity and achieve stable, long-term development in agriculture.

Achieving stable, long-term agricultural development requires both policy and science. In the policy area in particular, we should guide peasants in solving the problems of "excessively small economies of scale" and unchecked readjustments in the sectoral structure of agriculture, while at the same time implementing "spark plans."

One view holds that solving China's agricultural problems also requires raising prices. This view clearly diverges from China's current situation. Since 1979, grain prices have risen 110 percent, prices for cash crops have risen by more than 60 percent, and the state's price subsidies for agricultural and sideline products have now exceeded the ability of the financial departments to bear them. In a speech last year, Comrade Deng Xiaoping stated: "We are now moving ahead with a very heavy burden on our backs; several tens of billions of yuan each year in price subsidies are a heavy burden, and they are getting heavier." (1) ("Build Socialism with Chinese Characteristics," (Revised and Enlarged Edition), page 134.) If prices of agricultural products are raised again, it will be hard to cast off the heavy burden on the financial departments. Furthermore, China's current grain prices are already higher than those on the international market; should they be raised further? Moreover, if agricultural and sideline prices are raised again, the masses will simply not accept it. One important reason for the poor results of industrial enterprises is that prices for raw materials (including agricultural and sideline products) have gone too high, and the enterprises are incapable of absorbing them. Clearly, any further increase in prices of agricultural and sideline products would not promote a benign economic cycle.

2. Control the scale of price subsidies. In countries around the world, the scale of price subsidies is kept in check; subsidy expenditures on things that yield good results account for a very small portion of financial resources. In the United States, for example, in order to stabilize crop production in the face of worldwide crop failures and grain shortages in 1972, "guaranteed prices" were applied to the purchase and sale of farm crops, with the price gap between inverted purchase and sale prices subsidized by the government; in the face of surpluses of agricultural products in 1982, subsidies were given for not planting, but these generally did not exceed 2 percent of financial expenditures. In Japan and France, price subsidies for agricultural products are also kept under 2 percent of state financial expenditures. In 1981 and 1982 in India, price subsidies accounted for 7 percent of financial income.

As described above, the price subsidies borne by China's financial departments have far surpassed their capabilities, and they must gradually be cut back. What subsidy levels should ultimately be is very difficult to estimate in percentages, since this is determined by the obligations of financial departments in economic development and reform.

The obligations borne by China's financial departments are different from those in capitalist countries. In addition to being responsible for national defense and for providing the state's administrative costs and expenditures, the former are also obligated to establish strong basic industry, regulate proportional economic relationships, and stabilize the economy; they are an economic

mainstay for developing the productive forces of socialism and an important force for regulating the national economy, and they must have adequate financial resources. Hence the less spent on price subsidies, the stronger this mainstay and regulating force; conversely, the more spent on price subsidies, the weaker this mainstay and regulating force will be.

China's economic system is still in a transitional stage between old and new, and the task of reform is still an arduous one; many reforms, including rural, enterprise, tax system, wages, prices for the means of production, etc., require support from the financial departments. Therefore, the less spent on price subsidies, the stronger this support from the financial departments, and the faster the pace of reform; conversely, the more spent in price subsidies, the less support financial departments will be able to provide and the slower the pace of reform.

We therefore believe that the current proportion of price subsidies in China's financial income not only cannot be increased but should be cut back, in an effort to bring it down to less than 10 percent during the Seventh 5-Year Plan. At the same time, given the goal of economic system reform, state-run enterprises should become independent economic entities taking responsibility for profit and loss, with enterprise success or failure determined by their own management levels and ability to adapt to market competition. Enterprise vigor should be strengthened primarily through reform and improvement of internal enterprise mechanisms; enterprises should not look to the state for reduced taxes and increased profits, or for extra subsidies. Only by gradually reducing the scope and amounts of price subsidies can we meet the requirements of economic system reform.

3. Strengthen control over current price subsidies and institute planned reform of them.

a. Delimit and reduce the scope of price subsidies. Price subsidies for major everyday necessities having the greatest impact on people's lives, such as grain, oils, and vegetables, should be continued for a time, but inappropriate subsidies on these items should be gradually discontinued. Subsidies on the agricultural means of production should remain stable for a time in order to promote the development of agricultural production. Price subsidies for manufactured goods for everyday use and semi-high-grade consumer goods (including some agricultural and sideline products) should be progressively eliminated as prices are adjusted and wages are raised.

b. Do away with the "big rice pot" type of subsidy and institute those subsidy methods that provide mechanisms for internal vigor. For those industrial-sector goods using as their raw materials agricultural products subsidized by the state and by local governments, allocated supply prices may be suitably raised depending on the sector's profits, with the industrial sector bearing

part of the subsidies. "Norm contracts and no subsidies for excess losses" could be instituted for the commercial sector and for enterprises suffering losses of a policy nature, with subsidies linked to business volume, thus mobilizing the enthusiasm of enterprises with losses of a policy nature for increasing production and practicing economy, and reducing subsidies. Separate handling of parity-price grain and negotiated-price grain and independent accounting could be instituted on a trial basis in certain areas according to changes in grain-supply relationships, which would be helpful in separating losses of a policy nature from operating losses in grain enterprises. At the same time as parity prices and negotiated prices are separated, negotiated-price operations could gradually be expanded and parity-price operations stabilized, so as to exploit the role of state-run enterprises in holding down grain prices. As for subsidies to grass-roots shops dealing in subsidized goods, collective and individual contracts could be used, first checking the unit's subsidy norms for grain, oils, vegetables, and nonstaple foodstuffs and determining subsidies according to the contractor's sales volume, with any surplus after costs reverting to the contractor and any excess costs borne by the contractor.

c. As for the sector in which subsidies are applied, subsidies in the purchasing sector should first be shifted to the sales sector, then gradually concentrated in the consumption sector. Many subsidies are now concentrated in the purchasing sector, and although this is helpful in ensuring normal turnover in the commercial sector's funds, in purchasing and in selling it is difficult to distinguish parity prices from negotiated prices and to maintain control over them, causing many loopholes in the subsidy system: some falsely report the volume of negotiated-price purchases, while others report negotiated-price sales as parity-price sales in order to walk off with state subsidies, which leads directly to operating losses being subsidized. Therefore, concentrating price subsidies in the sales sector will help prevent and rectify these unhealthy tendencies, and the state will be able to provide subsidies according to actual monopoly sales volume; it will also facilitate delimiting the boundaries of negotiated-price operations and improving management in commercial enterprises. The state will also be able to use guideline plans to apply the price-subsidy lever to mobilizing the enthusiasm of commercial enterprises for keeping down prices and stabilizing markets, while at the same time encouraging enterprises to diversify and increase enterprise vigor while meeting state plans. As for the turnover of funds used to purchase agricultural and sideline products, an approach involving prepayment at the start of the year and settlement at the end of the year, with deduction of interest, could be used.

For the long term, subsidies in the purchasing sector are also not helpful in exploiting the regulatory effects of the law of value or in establishing reasonable parity among commodities. Such subsidies do not serve to promote production and operations, and they may also intensify



conflicts in commodity supply and demand. Subsidies should therefore be progressively concentrated in the consumption sector. This could be done in three stages: 1) Eliminate subsidies on manufactured articles for everyday use; if subsidies continue to be applied to such semi-high-grade consumer goods as meat, fish, eggs, and poultry, supplies to urban consumers could be limited, with anything in excess of those limitations supplied at market prices. This stage must be accompanied by an increase in staff and worker wages. 2) While maintaining subsidies for grain, oils, cotton, coal for home use, and vegetables, decontrol the prices of meat, fish, eggs, and poultry, and solve the problem of inverted linkage of purchase and sale prices for some consumer goods. This stage must be accompanied by a further increase in staff and worker wages. 3) As enterprise results and staff and worker wages undergo significant increases, even out the prices for all commodities subject to inverted linkage of purchase and sale prices; for any commodities still requiring subsidies, the subsidies would be given directly to consumers according to the allocated supply.

d. Institute a price subsidy system in which the burdens are balanced. 1) For agricultural and sideline products, those who allocate them should bear the burden: price differences and allocation costs for agricultural and sideline products and the agricultural means of production centrally allocated by the state should be borne by the central financial departments, while those for locally allocated agricultural and sideline products and the agricultural means of production would be borne by the local government to which they are allocated. 2) Subsidies should be borne by those who institute them. If a local government on its own adds new subsidy categories, the subsidies should not come out of its income before sharing with the central government but rather after local income is shared. 3) Subsidies for operating losses borne by grain-producing regions should be borne instead by grain-consuming regions, so as to mobilize the enthusiasm of grain-producing regions to increase their productive inputs and heighten the sense of responsibility of the region receiving the grain for managing it.

4. Pave the way for a thorough solution to the price subsidy problem. At the same time as agriculture is stabilized and agricultural productivity is improved, the economic results of state-run enterprises should be constantly improved and state finances increased. We must now combine increasing yields and income and practicing thrift with intensifying enterprise reform, and continue resolutely with this for the long term; while perfecting the internal operating mechanisms of enterprises, we must reorganize product structure, produce more marketable products, improve product quality, lower consumption, economize on funds, and encourage profitable enterprises to increase their profits and losing enterprises to reduce their losses. Only by improving the economic results of enterprises can we steadily increase staff and worker wages, profits retained by enterprises, and the state's financial income. Only when we have achieved steady increases in staff and worker wages,

profits retained by enterprises, and financial income can we gradually eliminate price differences in subsidized commodities with inverted linkage of purchase and sale prices, and only then will staff and workers be able to bear the added costs of thoroughly resolving the price subsidy problem.

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## SMALL-SCALE ENTERPRISES

### Tougher Regulations Needed to Stop Illegal Activities of Entrepreneurs

40060100 Beijing LIAOWANG [OUTLOOK] in Chinese No 51, 21 Dec 8 pp 21-24

[Article by Hu Guohua [5170 0248 5478], Liu Jinghuai [0491 2417 2037], and Chen Min [7115 2404]: "Profit-Driven Individual Entrepreneurs Evade Taxes and Take Advantage of Other Loopholes in Public Policy"]

### [Excerpts] Hired Labor Increasingly Popular

After years of growth, individual entrepreneurs have become a huge social group. Since people in this group differ from others in the way they run their businesses and deal with people and in their way of life, they have introduced new conditions and new issues into China's social economic life. One of the more notable issues is hired labor.

The hiring of workers has become widespread in the individual economy. Once their operations reach a certain scale, most individual enterprises must hire some workers. The hiring of a few hands to relieve labor shortage is permitted by public policy. However, the number of employees of many private enterprises has exceeded the official limit. A host of individual enterprises have become large employers, some of them hiring more than 100 people, and it is now commonplace for a private entrepreneur to hire a dozen people. Xinma Metal Works in Gangyan Xiang in Chongming County outside Shanghai lacks any decent production equipment, yet it specializes in the assembling and marketing of cord switches. The owner purchases the parts which will then be put together by hired workers using screw drivers. It hires 356 workers at most and over 40 at least. Even such a factory chalked up an output value of 1.8 million yuan between July 1984 and December 1985. Hired labor has enabled the owner to make a big fortune.

In its survey on 10 individual enterprises, the Jilin Provincial Industry and Commerce Bureau found that they hired a total of 395 people year round, for an average of 39.5 workers per enterprise, ranging from 150 people at most to 4 at least. The 10 enterprises boasted a combined capital of 375 million yuan, or 373,000 yuan apiece, ranging from 1 million yuan at the high end to 20,000 yuan to the low end. Their total annual sales



reached 6.07 million yuan, or 600,000 yuan each. Their annual revenues amounted to 400,000 yuan, or 40,000 yuan per enterprise, ranging from 85,000 yuan from 5,000 yuan.

There is a rising trend among individual entrepreneurs to violate government regulations on hired labor. A study in Zhejiang shows that as many as 2,400 individual enterprises now hire more workers than officially allowed. In Zhejiang, a study on 34 cities and counties by the provincial Industry and Commerce Administration Bureau also shows that 325 have exceeded the state limit on hired hands.

According to the 1986 statistics of the Liaoning Industry and Commerce Bureau, 17,749 individual enterprises exceeded the official limit on the number of hired workers by hiring a total of 83,516 people, of whom 80.2 percent were surplus rural workers and 19.8 percent idle urban residents and young people waiting for jobs. These 17,749 entrepreneurs had an average sales volume of 30,000 yuan. The agency estimated that 0.35 percent of all individual households hired more workers than allowed by government regulations, not a large proportion, but considerable absolutely.

There are also many aspects about the distribution accruing to owners and hired workers that are worthy of attention and investigation. Studies show that in some areas, the gap between the wages of owners and employees does not seem excessive on the surface. But since the owner controls the ownership of the final profits, the gap between owners and employees is wide in terms of final earnings. There is an individual entrepreneur in the clothing business in Shanghai who sets his own wage at 120 yuan, compared to 80 yuan for each employee. Thus the superficial difference is a mere 50 percent. However, he made a net profit of 27,463.91 yuan in the few months from May to December 1985 alone, averaging 3,433 yuan per month. Add his self-determined wage, and his monthly net income amounted to 3,553 yuan, 44-fold that of his workers.

The Shanghai Industry and Commerce Bureau knows of some large employers who hire out-of-town peasants unfamiliar with market conditions at patently depressed wages in order to jack up their own profits. These peasants do not do any less work than their local counterparts, yet earn one-third to one-quarter less. Then there are those large employers who, to maximize their working capital, pay their workers only 30 to 50 percent of what is due them, withholding the rest in the name of "year-end settlement."

Everywhere it is also commonplace to find employers who, ignoring their workers' health, induce them to overwork by dangling in front of them the bait of high piece-rate wages. At individual households that pay piece-rate wages, employees all work more than 12 hours every day, even 14 hours or longer. If this goes on for a long time, workers' health is bound to be impaired.

To cut production costs, some employers even allow workers to engage in production under extremely poor working conditions.

The problem of hired labor has become an issue in the development of the individual economy that is highly worthy of study. Clearly we cannot turn a blind eye to the violations of state standards on hired labor. How many workers should an employer be allowed to hire? Can we do without a limit at all? How do we handle the distribution relationship between employers and employees? How do we protect the interests of employees? No doubt the time has come for formal legislation to resolve this string of questions. To ensure the healthy growth of the individual economy, there is also a strong need for an open discussion and exploration at a theoretical level of the issues raised above. That would help unify our thinking, dispel misgivings, and point up a clear direction.

#### **Regulation of Private Enterprises Should be Strengthened**

The increasing popularity of hired labor has fueled the growth of China's private enterprises. According to preliminary statistics by the departments involved, individually operated entities of an enterprise nature now total 40,000 nationwide, 0.3 percent of all individual households. In addition, there are 200,000 private economic entities said to be cooperatively or jointly run. Then there are those collectively-owned enterprises which take on the characteristics of a private enterprise after being contracted by an individual. It is impossible as yet to calculate the number of these enterprises, but we can be certain they number in the tens of thousands.

Most private enterprises are currently concentrated in industries and trades closely related to the daily life of the masses, such as light industry, handicrafts, transportation, housing construction and repair and, to a lesser degree, commerce, catering, service, and repair. Few have ventured into heavy industries like machine-building, mining, and metallurgy. According to one study conducted in Shenyang, Yingkou, Fuxin, Dalian, and other cities in Liaoning by the agency involved, the industry mix of private enterprises in those localities consists of light industry, handicrafts, transportation, and housing repair, which between them account for 80 percent of all enterprises on the average, with commerce, catering, service, and repair accounting for another 20 percent.

The overwhelming majority of the operators of private enterprises earn more than 10,000 yuan, with the richest making several million yuan. Reports suggest that a small number of private enterprises along the southeast coast boast fixed assets and working capital approaching 10 million yuan. There are few such enterprises at the moment, but if we leave them alone and do not impose any curbs, a host of such enterprises will have emerged within 2 to 3 years, including some with total fixed assets

and working capital exceeding 10 million yuan. A very good example is the Putian Optical Electrical Machinery Plant, a private enterprise run by three brothers surnamed Lin in Putianshi, Fujian Province. It took the three brothers, Lin Jindou [2651 6855 6258], Lin Jinyao [2651 6855 5069], and Lin Jinmou [2651 6855 6180] just 5 years to multiply the plant's assets to 8 million yuan and it will not be long before they break the 10 million barrier. The way things are going, the three brothers are entirely capable of becoming China's "multimillionaires."

Apart from those in a handful of large cities, most private enterprises are located in the outskirts of towns because of space limitations and other reasons. Studies show that 90 percent of private enterprises in the Wenzhou area in Zhejiang can be found in the villages surrounding the city. In Liaoning, too, 90 percent of the private enterprises are located in villages ringing cities and county towns. In the provincial capital, Shenyang, 98 percent of enterprises are located in townships in the outskirts, with less than 2 percent located in the city. Of all private enterprises in Yingkou, 65 percent are in the villages.

No doubt private enterprises have brought a variety of benefits to China's economic construction, but their emergence also has introduced many new conditions and factors that need to be considered. For instance, to get hold of raw materials or to market their products, not a few private enterprises resort to such tactics as wining and dining, sending expensive gifts, and offering large payoffs so as to establish good relations and smooth their way. Such illegal practices as bribery and quasi-bribery clearly exist, to the detriment of the social climate and corrupting some government cadres. Moreover, much of their economic operations is short-sighted, with some going in for predatory business, which seriously damages our natural resources. In addition, there is now no effective regulation of the owners of private enterprises who have very high incomes.

As burgeoning entities which have grown substantially in recent times, private enterprises should be closely watched by all agencies concerned. At the moment, their presence is a mixed blessing, with the advantages largely outnumbering disadvantages. But if we fail to pay them special attention, examine their problems in earnest, and limit their shortcomings, the consequences may be serious.

#### **Illegal Exploitative Operations Cannot be Ignored**

Most individual enterprises know how to do business. They are well-informed about the market and act accordingly, using their principal to make profits. And by and large their business activities are legitimate. But there are also people who sacrifice principle for profits and are bent on exploiting loopholes in public policy. As long as there is money to be made, they would do anything to make a killing, even if national interests are

damaged. Their business operations are highly mysterious and sometimes blatantly illegal. We should make these problems our priority and look into them conscientiously.

In its survey on the operations of individual households in 1985, Wuhan discovered that a good number engaged in illegal activities. This year the city investigated a total of 4,245 cases involving individual operators who have broken the law. Most of them have resold at huge profits materials whose trading is prohibited by the state, swindled, offered bribes, made and sold shoddy or bogus products, or forged trademarks.

That these people can sometimes go about their business without hindrance has something to do with the bribes they offer to workers in state-owned and collective units in order to draw them over to their side and corrupt them. To win contracts, sell their products, and ensure energy supplies, some individual households often depend on bribery to smooth the way for them and engage in activities that hurt the state, the collective, and the masses in collusion with the employees of state and collective units. For instance, in its investigation of economic crimes in 1985, the judicial department in Baoding, Hebei, discovered that 26 individual households offered over 80,000 yuan in bribes to the units that had business dealings with them. Twelve individual households paid bribes to win a contract to put up insulating tiles at the Baoding Petrochemical Plant. They offered four employees in the plant's supply section a total of 13,424 yuan in bribes, with one household paying the highest sum of 3,800 yuan.

Certainly, people in party and government organs or state-owned enterprises have themselves to blame if they, driven by a desire for personal gains, allow themselves to be drawn into criminal activities and are punished in accordance with party rules and the law of the land. They should not hold others responsible for their problems. Nevertheless, it should be noted that a good number of economic crimes involve collusion between people inside and outside government. A handful of people abuse public office for personal interests, and it is exactly by exploiting their power that opportunists achieve their goals. We should give this kind of collusion our full attention.

Many individual households in Shanghai and Zhejiang are engaged in processing with issued materials, usually making clothing, bras, ties, handbags, and other relatively simple products. Processing contractors include township and town enterprises as well as individuals. With many categories of raw materials in short supply, even state-owned and collective enterprises are hard pressed to obtain them in sufficient quantities. How then can the individual household ensure a constant source of supply? The secret is that individual households, taking advantage of the unhealthy trends in society, pay off people who keep them supplied and other middlemen. To purchase one bolt of cloth, you usually have to offer

the supplier or middleman a "tip" ranging from a few jiao to a few yuan. Since both sides profit from it, this relationship has gone on for a long time. According to investigations, individual households in the Liulin small commodity market in Luwan District, Shanghai, who are engaged in processing with issued materials and batch sales generally earn 2,000 to 3,000 yuan in profits per month, as much as 10,000 yuan in some cases. Those who receive payoffs "profit" by at least hundreds of yuan each month.

An individual entrepreneur in Huangbo County, Hubei Province, hired 600 people and set up a construction company to specialize in contracting construction jobs in Wuhan and surrounding cities, large and small. Through payoffs, he managed to get hold of jobs unavailable to other construction teams and companies. Since its establishment in 1979, the enterprise has accumulated over 700,000 yuan worth of fixed assets and more than 90,000 yuan in working capital.

It will be worth our while to study and consider how to regulate and limit the operations of this kind of people.

#### **Tax Evasion Must be Curbed**

Tax evasion is widespread among individual entrepreneurs. While tax agencies across the country have done a lot of work, the practice has not been checked despite repeated crackdowns. Workers in industry and commerce agencies tell us that there might not be many who deliberately evade paying taxes, but people who underpay are legion.

In a major tax inspection in the southern district in Shanghai in 1985, 1,201, or 90 percent of the 1,324 households inspected, were found to have evaded or underpaid taxes. A targeted inspection in Zhabei district revealed that of the 2,429 households investigated (59 percent of all tax-paying households in the district,) 98.5 percent, or 2,393, evaded or underpaid taxes.

In 1985, the Shenyang Tax Bureau inspected 27,897 individual industrial and commercial households and discovered that 77 percent evaded or underpaid taxes. They were required to pay a total of 1.04 million yuan in assorted back taxes.

In a major tax inspection involving 293,222 households, Jiangsu Province discovered that 154,864, or 52.81 percent, evaded or underpaid taxes to the tune of 13,566,900 yuan. That over half of the individual households evaded taxes is quite shocking.

Some individual households spend money freely and indulge in conspicuous consumption. When it comes to fulfilling their tax obligations to the state, however, they rack their brains to find a way to delay or avoid payment. Large households evade paying large amounts of taxes, while tax evasion is rampant among small households.

There is an individual entrepreneur surnamed Kang in Chengdong District in Beijing who runs a restaurant. In the 14 months the restaurant was in business, she had revenues exceeding 213,000 yuan. To avoid paying taxes to the government, however, she reported only 94,800.66 yuan in revenues, under-reporting her income by about 118,200 yuan. In the process she cheated the state out of 23,577.42 yuan in combined sales, income, and urban construction taxes, 83 percent of the taxes due for the period concerned.

Tax evasion and underpayment by individual entrepreneurs assume myriad forms, notably the following.

First, some people keep phony accounts to cover up actual sales. According to investigations, many individual households keep two sets of books, with vast differences in their numbers. To convince the inspector, some individual households are meticulous about recording small amounts but fail to record large sums received. In a major city-wide tax inspection in 1985, Chongqing uncovered 3,673 tax evaders among 7,183 individual households, or 51 percent of the households examined. Most of the evaders under-reported sales revenues by keeping bogus accounts or by failing to record receipts altogether. In 1987, 78 permanent stalls in the Xiaolongkan industrial and commercial area in the city's Shapingba District reported total sales of 677,000 yuan, which subsequent investigations showed to be only 35 percent of actual sales revenues. Between 1983 and 1985, an individual entrepreneur in the wholesale business in Hanzheng Street in Wuhan, Hubei, under-reported business revenues by over 700,000 yuan and underpaid taxes by 25,000 yuan, 3.7 times his declared tax liabilities.

Second, some individual entrepreneurs fail to register with the tax bureau after opening for business. Individual entrepreneurs apply for permits from the industry and commerce bureau and register with the tax bureau at different times. Regulations stipulate that they must register with the tax bureau and pay taxes as required within 15 days after they obtain a business permit. Nevertheless, a small number of people simply did not register with the tax bureau after getting hold of their business permits. Consequently, the tax bureau missed collecting taxes from them for years.

Third, some do not operate in accordance with regulations. The tax agency issues restaurant owners a uniform set of "three-in-one coupons for restaurants operated by urban and rural individual households." Under regulations, when a customer eats at a restaurant, the operator is required to list the cost of the meal on the coupon, giving one copy to the customer, one copy to the chef, and keeping one as a record for the amount of business done. But many individual households in the restaurant business simply do not use the coupons in order to underreport their incomes and hence underpay taxes.

Fourth, some do business under the table, with no receipt, no entry in the account book. Under-the-table deals benefit both sides. The only party injured is the state. Then there are those who take advantage of the fact that buyers often pay attention to the receipt only and overlook the stub and juggle with the numbers on the stubs by making them smaller than their counterparts on the receipts.

That tax evasion and tax underpayment are serious and widespread points up our regulatory weaknesses. Apart from stepping up the education of individual entrepreneurs and making them obey the law, comply with discipline, and pay taxes as required by law, we must tighten regulation, reinforce the tax collection contingent, speed up the formulation of relevant laws and regulations, and set up a sound and scientific management system.

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### **Rapid Progress of Town, Township Enterprises Reported**

40060081 Beijing JINGJIXUE ZHOUBAO in Chinese  
15 Nov 87 p 3

[Article by Ma Jiesan [7456 2638 0005], Director of the Office of Town and Township Enterprises, Ministry of Agriculture, Animal Husbandry, and Fishery: "Town and Township Enterprises Grow Rapidly Amid Reform and Decontrol"]

[Text] Since the 3d Plenum of the 11th CPC Central Committee, town and township enterprises have grown rapidly like bamboo shoots after a spring rain in China's countryside, guided by the policy of "reform, decontrol, and invigoration." In 1986 the country had more than 1,500 town and township enterprises, a ninefold increase over 1978; they employed 79.37 million people, 1.8 times the number in 1978; their gross output value was 354.1 billion yuan, including 241.3 billion yuan in industrial output value, accounting for more than one-fifth of the country's gross output value and industrial output value for the year, which increased 6.2 times and 5.3 times over 1978. In the last eight years or more, town and township enterprises have grown at a rate of 28 percent annually, and more than 70 percent of the net increase in gross output value in the countryside came from these enterprises. In just a few short years they have not only developed into a mainstay of the rural economy but have also become important components of the national economy as well. Their role and social results are being taken more and more seriously by people, and they have attracted the public's attention.

1. They have changed the exclusively agricultural structure of the rural economy and allowed the coordinated development of primary, secondary, and tertiary industry. The proportion of rural gross output value accounted for by the output value of these enterprises rose from 21.7 percent in 1978 to 54.6 percent in 1986. Comparing

1978 and 1986, the structure of the rural gross output value by industry changed as follows: agriculture declined from 73.8 percent to 46.4 percent, industry rose from 22 percent to 37.2 percent, construction rose from 2 percent to 8 percent, communications and transport rose from 1.2 percent to 4 percent, and commerce and the hospitality industry rose from 1 percent to 4.4 percent. The growth of these enterprises has promoted a gradual diversification of China's rural economic structure.

2. The town and township enterprises have provided a way of local absorption of the surplus rural labor force by "leaving the land without leaving the countryside, getting into factories without going into the cities" that conforms to China's actual situation. Employees of town and township enterprises now account for one-fifth the total rural labor force. From 1979 to 1986 these enterprises found jobs for 51.1 million people in the surplus rural labor force, accounting for 66.8 percent of the net increase in the rural labor force during that period, representing a rate of 6.4 million new jobs annually; this has promoted a reasonable readjustment in the structure of the rural labor force and has freed the 800 million peasants from their backward ties to the land.

3. Supplementing agriculture with industry and building agriculture by means of industry have promoted agricultural development. According to incomplete statistics, in the last 8 years a total of 11.6 billion yuan in profits from collective town and township enterprises has been applied to agricultural production, thus promoting farm mechanization. During the Sixth 5-Year Plan, more than 7 billion yuan in profits from these collective enterprises was distributed among people engaged in agriculture, effectively mobilizing people's enthusiasm for agriculture.

4. These enterprises have increased the state's income and reduced its expenditures. During these 8 years, taxes paid to the state by these enterprises have increased at an annual average of 30 percent, reaching a cumulative total of 60 billion yuan. During the same period, these enterprises, relying on their own inputs, have produced many products urgently needed for national plans and the people's livelihood; in coal production alone, there was a net increase of 187 million tons, accounting for 68 percent of the national increase in coal, saving the state large amounts on investments. At the same time, expenditures normally having to be borne by the state's financial departments in such areas as rural education, health, and small urban construction projects are now being taken on by the town and township enterprises.

5. They have improved industrial distribution and urban-rural relations. By developing construction, tertiary industry, and lateral economic ties, the town and township enterprises worked their way into the cities, and urban industry radiated outward into the town and township industries by means of such advantages as equipment, capital funds, skilled personnel, technology,

and information, gradually turning around the traditional division of labor between urban industry and rural agriculture; urban-rural ties have become steadily closer, and industrial distribution is becoming more rational. In the last 8 years the output value of these enterprises has experienced an annual net increase of more than 25 billion yuan; in 1986 the output value of 12 town and township industries alone accounted for more than one-fifth of that in the same industries nationwide; 75.8 percent of this was extraction of construction materials and other nonmetal ores; 67.7 percent was manufactured construction materials and other nonmetal ores; and metal products, processed lumber, goods manufactured from bamboo, palm fiber, and straw, extraction of ferrous metals, and plastic manufactured goods all accounted for more than 30 percent. In terms of output, clothing accounted for 46 percent and raw coal accounted for 26.8 percent. This is all primarily labor-intensive production utilizing local resources. At the same time, machine manufacturing is an adjunct to large urban industries and has accompanied the development of large industry.

6. They have strengthened the collective economy, promoted new rural construction, and increased peasant income. In 1986 the collective enterprises at the township and village levels had more than 130 billion yuan in assets, a net increase of more than 100 billion over 1978. In the last 8 years, peasants earned more than 210 billion yuan in income from town and township enterprises; more than 20 percent of net peasant income came from town and township enterprises. In these 8 years, nearly 40 billion yuan in profits were used by town and township enterprises for collective welfare activities and the construction of small market towns and other new villages. The relatively concentrated growth of town and township enterprises has promoted the rapid creation of many small market towns serving as regional political, economic, and cultural centers. By 1986 their number had grown to more than 10,000, more than a fourfold increase over 1980. The rise of these small market towns has clearly narrowed the gap between urban and rural, industrial and agricultural, intellectual and physical labor, enriched the material and spiritual lives of the peasants, and produced a new type of peasant, one who understands technology and management.

7. Town and township enterprises are becoming a major force in the nation's exporting to generate foreign exchange. In 1986 income from product exports and labor services generated \$4.5 billion in foreign exchange for the state; in the first half of this year, deliveries of export products by some coastal cities increased by more than 80 percent over the same period last year; the increase in quantity and variety of products along with improved quality earned a reputation for the country.

In the first half of this year, town and township enterprises took advantage of the favorable opportunity brought about by urban and rural economic reforms; pursuing internal reform, improving their own quality,

and enthusiastically developing "dual increases and dual savings," they continued to develop quickly and healthily. In comparison with the same period last year, their gross output value increased 35 percent; taxes paid to the state increased 30 percent; and net profits increased 14 percent. In terms of national development, there are two salient features to this: 1) Production is increasing quite evenly in town and township enterprises in all provinces, municipalities, and regions. 2) Economic results improved, with significant increases in output value, profits, and taxes.

China's town and township enterprises are great creations of the development of commodity production by the masses of peasants in the midst of rural reform. In summing up the experience of this development, the Central Committee and the State Council stated that the development of these enterprises is necessary to stimulate China's rural economy; at the same time, they formulated a guiding policy of "positive support, rational regulations, proper guidance, and improved management."

In order to accelerate the growth of the rural commodity economy and the pace of peasant enrichment, so that the peasants can attain a comparatively well-off standard of living, before the year 2000 more than 100 million surplus workers must be shifted away from agriculture. This important task falls mainly to the town and township enterprises, and this is an important means of building a characteristically Chinese socialism. Therefore, these enterprises must undergo significant development and make an even greater contribution to modern socialist construction in China.

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## FOREIGN TRADE, INVESTMENT

### Soviet Official On Prospects For Sino-Soviet Trade

40060084 Shanghai SHIJIE JINGJI DAOBAO in Chinese 7 Dec 87 p 16

[Article by Yevgeniy Pavlovich Bavrín, deputy minister of foreign trade: "Bilateral Trade Between the Soviet Union and China Has a Bright Future"]

[Text] The Soviet Union and China have made significant headway in bilateral trade in the 1980's. After years in the doldrums, bilateral trade reached almost 4.5 billion Swiss francs in late 1986, the highest in 25 years. Between 1981 and 1986, Sino-Soviet trade expanded more than nine-fold, along with a marked increase in the variety of products the two countries export to and import from each other as well as changes in the product mix.

Soviet exports to China include automobiles, commercial aircraft, generating sets, and railroad freight cars and electric locomotives for trunk lines. The Soviet Union

also exports to China a wide assortment of industrial raw materials, pig iron, steel, steel pipes, electric cables, nonferrous metals, chemical fertilizers, building materials, and timber.

Gratifyingly, economic cooperation between the two nations, namely the supply of certain equipment, design, and the despatch of experts, has increasingly benefited the growth of bilateral trade. While such cooperation remains on a modest scale, its development prospects are excellent. Representatives from both nations are currently working to better tap the potential in this area.

Traditional products loom large in Chinese exports to the Soviet Union. They consist of textiles, clothing, knitwear, and other daily consumer goods so popular among the Soviet people. In addition, China supplies the Soviet Union with many agricultural products, corn, soybean, meat and processed meat products, and fresh fruit and vegetables. More recently, machinery and technical products also have secured a firm foothold in China's lineup of exports to the Soviet Union, including car batteries and hand tools. In the future, we must devote ourselves to fashioning new forms of bilateral economic relations and trade and new modes of cooperation, such as industrial cooperation and the establishment of joint ventures.

The list of Chinese exports to the Soviet Union in 1987 features a number of new commodities: accessory parts for railroad cars and electric locomotives made by the Soviet Union for China, dual radio cassette belt devices, and industrial sewing machines.

The trade protocol this year also provides for an increase in the range of articles of daily use China exports to the Soviet Union. Under a bilateral accord, the Soviet Union will resume sending ships to Chinese shipyards for repairs. This year Chinese experts completed the renovation of Beijing Restaurant in Moscow, which has already become one of the favorite restaurants of Moscow residents and foreign tourists.

While both the Soviet Union and China today can rightly claim that bilateral trade is developing steadily and strongly, some problems clearly remain.

The value of bilateral trade will drop in 1987 despite the fact that its volume will stay the same as in the previous year. This is mainly due to price changes affecting some commodities on the international market, commodities that account for a not insignificant chunk of bilateral trade. But even more important, we should take note of the vigorous efforts made by both sides to remove certain short-term dislocations. Some barter trade, for instance, was conducted this year, which up to a point has helped maintain our trade at a high level. In both the Soviet Union and China, the departments concerned are working hard to expand transport capacity to facilitate merchandise shipment. In 1987, river transport lines

were opened at the border for export shipment, connecting the Soviet river port of Nizheleninskoje with its Chinese counterpart, Tongjiang. A river transport agreement linking Blagoveshchensk (in the Soviet Union) and Heihe (in China) also has been concluded. The volume of river-transported cargo may seem insignificant now, but river transportation has a bright future in Sino-Soviet trade.

The Sino-Soviet inter-governmental commission on economic, trade, scientific, and technical cooperation plays an important role in furthering bilateral economic relations and trade. The commission held its third meeting in Moscow last May. It was noted at the meeting that as a result of mutual efforts, great progress has been made in all areas, including cooperation in two-way trade. On 13 May, Chairman Ryzhkov of the Soviet Council of Ministers received at the Kremlin Chinese Vice Premier Yao Yilin [1202 0181 2651], who led the Chinese delegation to the second meeting of the inter-governmental commission. The two parties discussed the steady development in bilateral economic relations in recent years and expressed a mutual interest in furthering such relations.

That the two countries have resumed the practice of holding exhibitions in each other has promoted bilateral economic relations and trade and helped them better understand the other party's achievements and potential.

The Chinese economic and trade exhibition in Moscow in July and August 1986 was a success, as was the Soviet industry and trade exhibition held in Beijing in December the same year. Both have strengthened Sino-Soviet economic relations and trade. The Soviet Industry and Commerce Council and the Chinese Council for the Promotion of International Trade have reached an agreement under which the Soviet Union will exhibit in China and vice versa between 1987 and 1990, thus laying a planned and solid foundation for the exchange of exhibitions between the two countries. In accordance with this agreement, China took part in the building industry international exhibition in the Soviet Union in 1987. The Soviet Union participated in the Beijing international book exposition in 1986. The Chinese also took part in the Moscow international book exposition in 1987. In November and December the Soviet Union will display samples of Soviet products in three Chinese cities—Harbin, Shanghai, and Xian, having first done so in Beijing, Nanjing, and Guangzhou where 20 major Soviet foreign trade companies exhibited the samples of over 1,000 products. The exhibition was visited by 27,000 Chinese experts from all industries. It is hoped that the Soviet product samples exhibition this year will be even more successful.

The future of Sino-Soviet economic and trade cooperation will depend to a large extent on the profound changes now taking place in the economic arena in both nations.

Chinese efforts to improve its economy comprehensively mainly manifest themselves in production growth, better product quality, active participation in foreign economic activities, and augmented decision-making power for foreign trade companies. We believe all this will mean new opportunities for developing Sino-Soviet economic relations and trade across the board.

Economic reforms taking place within our own country too will inject life into the development of bilateral economic relations.

Economic reforms now under way in both countries will certainly encourage the two sides to work harder to create new and advanced forms of production cooperation, nurture direct relations between Chinese and Soviet industrial enterprises and agricultural organizations, and set up joint ventures.

It should be said in passing that production cooperation has already appeared between us. As the first step in production cooperation, for instance, China supplied the accessory braking devices and automatic links for railroad cars and electric locomotives made by the Soviet Union. I believe we should take the joint-venture approach firmly and unequivocally as a way to broaden and deepen production cooperation.

Right now the two countries are discussing this question intensively and enthusiastically: How to develop economic and trade relations between, on the one hand, the republics, the border regions in the Russian Federation, union republics, ministries, and relevant departments in the Soviet Union which are authorized to import and export and, on the other, Chinese provinces, municipalities, and autonomous regions? And what would be the most sound and appropriate forms for such relations? Also under consideration are the major principles governing the establishment and operations of joint ventures. The conclusion of an agreement on these matters no doubt will push our economic and trade relations to a new level.

Finally, I hope that the product sample exhibition to be held in Harbin, Shanghai, and Xian by the Ministry of Foreign Trade and import and export companies under the industrial ministries will familiarize Chinese experts with the Soviet Union's new exports and give further impetus to Sino-Soviet economic cooperation.

Sino-Soviet economic and trade cooperation is charged with the glorious mission of contributing effectively to the strengthening of mutual understanding and friendship between the Soviet and Chinese peoples.

### **Indirect Regulation of Foreign Trade, Changes in Export Commodity Mix Urged**

40060086 Beijing GUOJI MAOYI WENTI in Chinese  
No 5, 87 pp 5-10

[Article by Zhou Xiaochuan [0719 1420 1557], member of the State Commission for Restructuring the Economy: "Changing the Export Commodity Mix Essential to Export Growth"]

[Text] 1. China Under Enormous Pressure to Adjust its Export Commodity Mix and Diversify Product Lineup

The intensification of China's policy of opening to the outside world and sustained domestic economic growth make it increasingly imperative that it exports to earn foreign exchange. The present foreign trade system does not work smoothly because of a lack of coordination. Moreover, with a shortage of foreign exchange, examination and approval procedures have been tightened level after level and foreign exchange is being distributed administratively, thus putting up new barriers in the way of the delegation of managerial powers. Instead of operating independently, enterprises have no choice but to depend on the higher authorities, in the process complicating the reform and development of the foreign trade system. To ensure export growth, we should accelerate the development of a system of indirect regulation over foreign trade and transform the export commodity mix. Three strategies are available to us as options:

1) Do our best to preserve the existing export commodity mix and export volume; 2) Establish export bases and develop "leading" products; and 3) Diversify our exports.

In the long haul, it is almost impossible to keep the existing export mix and export volume because of the law of evolution of the industrial structure. Export growth must be based on a drive to increase the sale of manufactured products. International experience proves that the development of manufactured products should stress "leading" products and a broad variety of products equally, which requires a combination of special "export base" policies and general policies that encourage exports across the board. Since the Seventh 5-Year Plan has elaborated in no uncertain terms a policy for developing export bases, I think our next step is to zero in on product diversification. This requires major solid progress in foreign trade reform.

Continuous development of the economic structure is an important hallmark of a growing national economy, while the continuous evolution of the export commodity mix is the hallmark of the development of an exporting nation selling products other than natural resources. Such evolution has been particularly marked in the case of countries with an economic growth rate exceeding the world average. This has been a law in international

economic development in recent decades. It follows that expediting changes in the economic structure constitutes a key economic development and export expansion policy.

In the beginning, the fast-growth developing nation depends principally on the export of primary products. As its economy expands gradually, domestic demand for certain primary products increases apace, the supply sources of exports shrink, and returns on domestic sales overtake those on export. As a result, the export of primary products drops or disappears. In 1985, for instance, an overheated domestic economy led to excessive overall demand in China, thereby exacerbating the phenomenon of diminishing export supply sources. Furthermore, the Seventh 5-Year Plan projects an average annual growth rate between 7 and 10 percent for the country, substantially higher than the world average. Under these circumstances, it was inevitable for the supply sources of primary products destined for the overseas market to shrivel. That domestic demand would grow at the expense of export sources is unavoidable; it is only a matter of time. Yet the fact that it happened a few years sooner rather than later did widen the disparity and make the change that much more abrupt.

Judging from the decline in the percentage of primary-product exports, both proportional and absolute, we may and would logically see a drop in the export volume of certain primary products, with some ceasing to be exported altogether. For instance, a number of fruits and vegetables at the middle and upper end of the market used to be luxuries at home. As the public's purchasing power goes up, the margin of economic returns on domestic sale may in some cases exceed that on export. Moreover, the component costs (resource costs and labor costs) of manufacturing those products are changing constantly. On the macroeconomic level, therefore, a case may be made for increasing their domestic sales while reducing their exports. The same argument applies to crude oil exports. Just what is the most appropriate level of crude oil exports? The answer can be found only through a rigorous comparison of the margin of economic returns on export with the margin of economic returns on domestic sale. The level varies from year to year. A key policy is to provide enterprises with a set of indirect control signals so that an industry can arrive at an export/domestic sale ratio consistent with what the macroeconomy requires. The set of signals are exchange rates, tariffs, export tax drawbacks, individual export support policies, and other mechanisms. With the so-called art of macroeconomic indirect control, the collective behavior of all enterprises as they practice business accounting and maximize profits should be consistent with the goal of stable, balanced national economic growth across the board. If administrative tools are overused to the degree that they prevent enterprises from functioning in accordance with the law of value, the organic relationship between export and domestic sale

will be severed and the development of the export commodity mix will be hampered, thereby affecting the evolution of the industrial structure.

Meanwhile, China's strengths as an exporter should be exploited in the manufacturing industry. Manufactured products exported overseas often consist of a limited number of large-batch "leading" products and a wide variety of small-batch products. And some "leading" products frequently emerge from small-batch products. There is another intrinsic reason for the evolution of the industrial structure: changing relative labor costs in the world economy. Because of rising labor costs, developed nations in the West have been forced to hive off some labor-intensive operations. (When the technology involved matured into a manufacturing process, the production of some high-tech products was moved to Southeast Asia and Latin America.) Low-income developing nations often export such manufactured products as textiles and footwear. As their per capita income soars, boosting their labor costs compared to the rest of the world, these countries will gradually lose their advantage as an exporter of simple manufactured good while gaining an edge in machinery and electronic products at the middle and lower end of the market which have a higher added value. Thus the implementation of a policy that complies with the objective principles of the evolution of the export commodity mix and expedites such an evolution is a major issue in export development.

The evolution of China's export commodity mix has been relatively slow for these three main reasons: 1) Its domestic price and tax systems have made it more advantageous to produce primary products than manufactured products (the greater the extent of processing, the more unfavorable it is to the manufacturer). As far as prices are concerned, therefore, the policy has been to encourage primary product exports, while discouraging the export of manufactured goods, a situation aggravated by distorted exchange rates. Despite a number of policies giving special assistance to the export of manufactured products, not enough has been done to offset the odds mentioned above. 2) The traditional over-centralized export system has robbed domestic enterprises of numerous opportunities to experiment in exporting and seek out their advantages. Excessively protectionist measures have freed some enterprises from the pressure to compete with imports. As a result, they have grown satisfied with the status quo. 3) Many export enterprises do not have direct contact with the international market and are hence unable to carry out proper business accounting as far as export is concerned. Even those who practice business accounting frequently come up with the wrong conclusion because of incorrect evaluation of exchange rates, tariffs, and subsidies. (For instance, in cases where export is preferable from a macroeconomic perspective, the enterprise may be persuaded by its own calculations to opt for domestic sale.) This shows that in foreign trade, economic levers are not working the way they should.



China exports only a small quantity of the manufactured products on the international market and earns little foreign exchange from them. As an exporter of manufactured products, its services are also poor. Another notable problem is its narrow product range. According to local market surveys in certain product categories, the variety of products offered by China is smaller than those of the "four little dragons" by more than 5 to 10 times. While China is entirely capable of making some of the things exported by the "four little dragons," China has lost and is losing the opportunity to export many product varieties because Chinese enterprises are ill positioned to stay in touch with the international market and conduct business accounting. As far as some varieties are concerned, China is not even in the "embryonic," not to mention "mature," stage. Not all "leading" products are the results of central planning; a number of large and medium-batch "leading" products have developed on their own from modest beginnings. Classic examples are the wigs of South Korea or the toys of Hong Kong of the 1960's. Both were mainstay exports. But neither was a key product launched by the foreign trade department or a particular industrial department. Instead both developed over time through the trial and error of a multitude of entrepreneurs. In missing the opportunity to germinate a variety of products, therefore, we effectively also missed the opportunity to nurture and export a number of potential "leading" products. In addition, even "leading" products have a limited life-cycle and must comply with the law of the evolution of the export commodity mix.

Certainly, a number of export manufactured products now at their peak can still expect to do well for the next 10 years and more. After assessing the situation correctly, we should establish export bases for such products. This is a completely necessary and effective policy. Particularly at a time when the domestic indirect regulatory system remains imperfect, it is easier to establish export bases, which also pay off relatively quickly. At present, both the Seventh 5-Year Plan and the policy encouraging an expansion in electrical machinery exports emphasize the building of bases and the adoption of special policies to nurture them. The next item to be put on the agenda is this: In what ways can we encourage export diversification? Moreover, we should integrate the base policy with the policy to encourage exports in general. This makes a tougher demand on foreign trade reform.

To meet this demand and ensure that export bases will turn out a diversified range of products instead of becoming the bases for "leading" products alone, we must apply the law of value further. The base policy should not degenerate into a means for isolating the interior and stepping up direct control. Instead it should revolve around the broadening of domestic-foreign ties and the conscious application of the law of value. And so should the foreign trade policies of special economic zones and coastal cities. In my opinion, the following issues should be threshed out during policy-formulation:

1) We need a policy to promote the creation of new products and the evolution of the export commodity mix, not one to make the existing product lineup and scale of production permanent. On the one hand, we need a base policy to develop exports and "leading" products. On the other hand, we need a series of policies to enable all sorts of enterprises (including enterprises on the bases) to explore the possibility of developing new products for export and carry out business accounting properly to assess export versus domestic sale. Only thus can exports be diversified to meet the requirements of an ever-changing mix. And only thus can exports flourish and grow steadily. 2) Turning to the export of multiple-processed manufactured products requiring the cooperation of a number of enterprises, even as we encourage the factory that ultimately puts together a product for export, we must also consider taking a series of steps to extend export support to enterprises down the line making parts and components and raw materials. This is the only way to ensure the high quality of the product overall. Many Chinese manufactured products generate little foreign exchange earnings. The problem lies with their components and materials: they are made by factories not receiving the appropriate encouragement. China's military industry and certain heavy industries boast well-equipped plants with a high level of technical expertise. We should encourage them to team up with export enterprises by supplying the latter with high-quality parts, components, and tools. We should also solve their working capital shortages and exempt them from import tariffs provided the working capital and imports are required for their indirect export production. 3) We have drawn up special policies for the three kinds of enterprises that are either partially or wholly foreign-owned, for special economic zones, and for bases mainly because of an unfavorable domestic economic environment where exchange rates, tariffs, prices, domestic taxation, and credit policies, among other things, remain in a chaotic state. When a sound indirect regulatory system is in place in the nation, some special policies should be rolled back. The state should provide more reasonable encouragements to all enterprises in the export business.

In short, only when special policies are combined with general policies can they work more effectively, a point that must be examined carefully during the next reform stage. Product variety is a major issue in export and must be tackled accordingly. We hope to take a number of simple feasible measures, but the complexity of economic systems sometimes dictates elaborate and complicated economic policies.

In the final analysis, the goal of our foreign trade policy is a flexible and effective indirect control system. This is determined by the momentum of enterprises and their ability to develop exports. It is also determined by the capabilities of the state for management and its effectiveness of a manager. Although the current price system and financial climate fall short of forming a positive environment, reform cannot stand still and wait; it

should go forward hand in hand. It is not only imperative and urgent, but also, to a certain extent, possible, for us to work hard to plan and implement an indirect regulatory system in foreign trade.

## 2. The Establishment Of An Indirect Regulatory System Is Vital To Changing The Export Commodity Mix

As economic structural reform advances nationwide, the foreign trade system too has undergone some changes. Through the proper delegation of managerial powers and the strengthening of industry-trade and technology-trade cooperation, import and export have been energized. In the course of experimenting, however, all manner of unhealthy things have occurred, notably the incompatibility of the profit-motivated export and import activities of microeconomic units with macroeconomic interests, and improper competition, damaging to macroeconomic interests, which has resulted from the inability of some microeconomic units to be totally responsible for their own profits and losses. The situation has drawn different assessments and different policy proposals. As I see it, the main problem is that indirect regulation has not caught up with the system fast enough. But the potential for improvement here is tremendous.

An important guiding idea behind economic structural reform is to mobilize the enormous potential within enterprises and workers and vastly improve economic performance by augmenting enterprises' decision-making power. Because China's current price system and price management system remain highly inequitable, however, some profit-motivated enterprise (and local) behavior has been at variance with macroeconomic interests and negative as well as positive things have resulted from reform. Accordingly, a way must be found to apply policy tools (generally speaking, non-price economic levers) to coordinate microeconomic behavior to bring it generally in line with macroeconomic interests. The trouble is that none of the traditional economic policy tools was designed with a diverse range of products in mind and could not effectively neutralize the negative effects of price signal distortions. Therefore, the creation and application of new coordinated policy tools to further guide microeconomic behavior is a crucial prerequisite for decentralization and economic vitalization as well as an inevitable product of macroeconomic management during reform. In 1983, Premier Zhao Ziyang called for a product tax precisely because such a tax could offset price distortions. Certainly, owing to various difficulties in planning, implementation, and supervision, the substitution of tax payment for profits has not yet fully produced the desired results.

A similar problem exists in the foreign trade system. We all realize that the only basic way to tap the potential in import and export and realize the economic benefits in those areas is to continue to broaden the autonomy of foreign trade and production enterprises and link their performance to economic interests. The pressure facing China to modify its export commodity mix and the

mercurial nature of the international market only add urgency to the demand for such a reform. Given the existing inequitable price system in the country, simply delegating power to enterprises and localities has resulted in an import and export commodity mix, the product of enterprise and local decision-making, that is unsound in the macroeconomic context. This problem is the same as that confronted in domestic structural reform. The starting point for the policy-maker should be this: Can suitable policy tools be identified that are capable of correcting the undesirable influences of an irrational price system on the import and export commodity mix and behavior? Such tools must be able to regulate a variety of commodities differently. Gratifyingly, the existing policy tools in import and export are targeted at a multitude of products. Tariffs, the regulator of import behavior, have historically been classified in detail by commodity. The cost standard for purchase and earning foreign exchange, the regulator of export behavior, or detailed regulations on import tax drawbacks, also can be classified in detail by commodity. Moreover, import and export licenses, which are administrative or semi-administrative in nature, are issued by commodity. Regulation using these tools is more flexible than that using domestic policy tools. Another advantage is that customs may supervise imports and exports strictly and effectively and provide a basis for the implementation of relevant policies. It may be said that if these tools are used well, we will essentially succeed in correcting the behavior of microeconomic units in import and export. The key question is whether or not we will take them seriously and make an effort to put them to good use. From the above-mentioned perspective of reconciling macroeconomic with microeconomic relations, as far as the gradual delegation of managerial decision-making power is concerned, the foreign trade system is better placed than domestic industrial enterprises. Be that as it may, a look at the actual progress made so far suggests that the majority of enterprises (particularly production enterprises) have meager decision-making powers in import and export.

## 3. Policy Tools To Achieve Indirect Regulation Of Foreign Trade

In drawing up tariffs under a given set of exchange rates, we must take pains to make up for the disparity between the two sets of prices—domestic and international—so that all importers, whatever they import, can only make a marginal profit. That accomplished, we should further fine-tune tariff rates to give some commodities just the right amount of needed protection or encouragement, while subjecting others to the right degree of restriction, in accordance with macroeconomic interests. If we set tariff rates without paying due regard to the domestic price system (and its dual nature) and carry out in isolation an industrial policy that seeks to restrict or encourage imports, we will not be able to achieve the desirable level of imports. In the past, we made it

possible for the importers of microcomputers, automobiles, color television sets, and certain raw materials to reap huge profits. The result was a wave of improper imports.

Detailed regulations on export tax drawbacks should reflect the export policy. To begin with, they must narrow the differences between domestic and international prices so that manufacturers of different products would be able to assess their export potential by referring to a more equitable form of cost accounting. In other words, they should largely neutralize the discriminatory effects of prices. On that basis, we should further use export tax drawbacks to give some exports the right amount of needed encouragement, while subjecting others to the right degree of needed restriction in accordance with macroeconomic interests and our development strategy. If we fail to consider fully the fact that primary products and manufactured products are generally underpriced and overpriced, respectively, under China's existing price system, which is an aberration, we will have difficulties rationalizing the export commodity mix and achieving the shift toward manufactured products, in the end effectively concentrating export enterprises in a few categories of microeconomically highly profitable products.

The fixing of exchange rates must be based on regulating the balance of payments and should help import and export enterprises practice serious and effective business accounting. If foreign exchange holders end up with certain imports that are particularly profitable as a result of tariff loopholes, not only will official rates become ineffective, creating a strong temptation to arbitrage, but enterprises will also be encouraged to export irrationally, perhaps even at a loss, with their losses on the export side more than offset by the huge profits from imports. This is precisely the problem we are facing now. Consequently, tariff exemptions in all manner and forms must be put under strict control. In the short run, the tax-free status accorded most personnel going abroad also should be reviewed.

If business accounting can be conducted under effective control for import/export and non-trade foreign exchange balancing activities, that would essentially bring about a single exchange rate, provided tariffs and the export subsidy system also are straightened out in the meantime. And with a single exchange rate, such major problems as balancing the foreign exchange of the three kinds of enterprises that are either partially or wholly foreign-owned, currency problems in special economic zones, and bills of exchange, also will be largely resolved. In the experience of developing nations, even economically weak nations with little capacity for export can achieve a single exchange rate and afford the free exchange of currency in trade despite the existence of domestic price distortions. So-called foreign exchange control refers to the strict management of non-trade foreign exchange expenditures and capital outflow (including the overseas remittance of profits by foreign

businessmen). It means that an exporter must settle his account with foreign exchange and that an importer must spend foreign exchange using the shipping list in order to prevent a drain on foreign exchange. Foreign exchange control, however, does not necessarily require import and export control. As long as the tariff system, the export tax drawback system, and business accounting are sound, there can still be a single exchange rate in import/export transactions and we can still afford an almost free exchange of currency.

In the area of finance, the export financial system should be substantially improved. On the one hand, working capital loans should be made available to exporters without delay. On the other hand, the nation's export industrial policy should be realized through lending activities. Moreover, through such mechanisms as guaranty and insurance, we should enhance the ability of the exporters of certain types of products to take risks, thereby reducing excessive disparities between different exporters and between export and domestic sale in terms of the risks they have to take and their financial conditions.

There should be a system of import licensing for those commodities whose import is allowed but which tend to be imported in excessive amounts (often as a result of the rigid price system at home), and a system of export licensing for those commodities whose export need encouragement, often provided in excess, as they face a restricted market. Given the nation's current export mix, which is unsound, creates sizable differences in returns, and is in acute need of an overhaul, and assuming an equitable tariff system, exchange rate and export tax drawback system, we may set aside a portion of the export licenses for issue through bidding and even allow their being traded on the market. Instead of doing any harm, such a move may actually increase the exports of those products which earn more foreign exchange compared to similar types of goods. In short, export licensing and quota management should be brought under one roof and not fragmented among several agencies. As for issue methods and the dissemination of issue information, there is still much room for improvement.

Then there is a number of commodities not amenable to regulation by policy tools. They should remain subject to the direct control of planning on either a short or a long-term basis. That way, we will have both administrative and economic tools at our disposal, even keeping the power to examine and approve and to alter the scope of export licensing under extraordinary circumstances, and will largely be able to reconcile macroeconomic with microeconomic interests. If we do not use economic signals properly, administrative orders alone will often prove unable to make the microeconomy fall in line and even administrative managerial departments may make mistakes, which happens often.

To employ the policy tools described above, foreign trade and planning departments should have a clear idea of the overall import and export commodity mix (including that outside the plan) in macroeconomic terms,

particularly staple imports and exports. The function of policy tools is to guide microeconomic interests to dovetail with macroeconomic interests. If we do not know exactly what our macroeconomic interests are, we cannot even begin to talk about guiding. (The situation would be different after prices are fully rationalized.) Thus, instead of being scaled down, foreign trade planning must actually be strengthened. But how we go about planning should depend on how the system is working. Command planning should be eschewed where it is not justified.

Because space is limited, I cannot discuss policy tool planning in greater detail. Still it is clear that a set of powerful policy tools awaits our use. Applied properly, they will promote foreign trade reform, thereby improving returns on foreign trade and boosting exports and imports. Needless to say, the application of these tools requires close coordination between and strong support from several comprehensive macroeconomic agencies.

In a word, we should not blame microeconomic behavior alone for the problems that have appeared in the trial reforms of China's foreign trade system over the past few years. Nor should we attribute them entirely to an irrational price system in the country. Instead, we should realize that serious flaws exist in foreign trade policy tools which, in principle, may be used with satisfactory results. After years of command management, we have been bogged down in burdensome day-to-day work and grown unfamiliar with the potential and methods of indirect regulation. Certainly there also are some individuals hankering after the power that accrues to practical work, exactly the kind of problem that has to be corrected in the course of reform. Furthermore, there is the question of to whom the power to conduct foreign trade should be delegated, enterprises or localities. On this, an issue common to several reforms in the nation today, the government should give us a clear common understanding. My opinion is that the power to engage in foreign trade should be more directly delegated to foreign trade and production enterprises.

There are four major points about indirect regulation as a principle:

- 1) Before prices are rationalized, we should understand clearly the goals of import and export and the import and export commodity mix on the macroeconomic level. Foreign trade departments should bring about an import and export mix required by the macroeconomy.
- 2) We need a set of tools that can effectively reconcile macroeconomic interests with microeconomic behavior. Since the tools are related to one another, we must make sure they are applied in a coordinated way and not attend to one thing while losing sight of another.
- 3) We must study and develop a good grasp of microeconomic motives and behavior (of delegating authorities). We must try to find out the responsiveness of

microeconomic behavior to policy tools and enhance such responsiveness (usually by stepping up business accounting and the responsibility system).

- 4) There should be a clear method to ascertain the numerical value of policy tools.

Judging from the main points above, we cannot just stand and wait for the indirect regulatory system to take shape. Instead we must actively go about putting it together. Whether or not the conditions are ripe depends on the feasibility of the points mentioned above, workload, and the costs of action. I believe the foreign trade system is equipped to accelerate the creation of an indirect regulatory system. The key question is how to achieve a consensus.

To ensure vigorous steady progress in foreign trade reform, we may consider taking the following measures to create an indirect foreign trade regulatory system gradually, further delegate to enterprises the power to conduct foreign trade, make foreign trade and production enterprises of all types responsible for their own profits and losses, and diversify our lineup of export manufactured products, thereby fundamentally ending our balance of payments deficit. 1) Rectify the tariff system in accordance with the principles above and strictly weed out tax exemptions and reductions granted by special permission. 2) Work out export tax drawback standards and strictly eliminate unreasonable price discrimination created by indirect domestic taxes and tariffs. We may start with manufactured products and then broaden the effort to other products in stages or in one step. 3) After steps 1) and 2) are implemented, most loopholes in the use of foreign exchange will have been closed. We then can either adjust the official exchange rates or take the more drastic move of allocating foreign exchange on the market to bring about a single exchange rate and slowly ease foreign exchange control in trade. 4) Improve licence issue and quota management. Commodities whose export need to be restricted should still be subject to effective administrative management. On the import side, there remains a need for more administrative control and supervision. However, control over imports which go into the making of exports as intermediate inputs should be relaxed. 5) Improve export credit, guaranty, and insurance policies and ensure such improvements organizationally.

On the basis of the policy tools discussed above, most foreign trade enterprises will be able to assume responsibility for their profits and losses and pay taxes instead of turning over profits. Meanwhile, various powers necessary to the conduct and development of foreign trade should continue to be delegated to foreign trade enterprises and qualified production enterprises. The use of agents and assessors also should be made more widespread. The Ministry of Foreign Economic Relations and Trade too will gradually be able to separate government from enterprise functions.

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# **Reforms in Macroeconomic Management of Foreign Trade**

Shanghai CAIJING YANJIU [THE STUDY OF FINANCE AND ECONOMICS] in Chinese  
No 10, 3 Oct 87 pp 43-47

[Article by Lu Jinhao [4151 6855 6275] under the column "Work Research": "On Restructuring China's Organizations for the Macroeconomic Management of Foreign Trade"]

[Text] *I. Current Defects in China's Organizations for the Macroeconomic Management of Foreign Trade*

It is characteristic of modern economic development for the division of labor to flourish simultaneously with cooperation. Correspondingly, it is characteristic of the development of modern management for the division of labor to flourish simultaneously with cooperation. On the one hand, the division of labor grows more and more detailed and exact, and on the other hand, the scale of cooperation expands and grows more intimate. Consequently, each of the four basic major functions of modern macroeconomic management—policy, implementation, supervision, and consultation—is important and indispensable and we must particularly be in command of policy. Because policy is the preeminent function of macroeconomic management, it embodies coordination and control, and therefore we often feel that policy, coordination, and control are the nuclear functions of macroeconomic management and that implementation, supervision, and consultation merely serve macroeconomic management. As for the means of achieving macroeconomic functions, we should depend on three major measures: laws, administration, and economics. In terms of organization, we should rely on a system of management organizations set up according to scientific principles.

In March 1982 China's State Council organizations underwent a major reform. During that reform the State Council eliminated or merged 14 ministerial and commission organizations and added two. After the reform there were still 41 ministries and commissions under the State Council. The current Ministry of Foreign Economic Relations and Trade was formed by merging the Commission for Import and Export Control, the Ministry of Foreign Trade, the Ministry of Foreign Economic Relations, and the Commission for Foreign Investment Control. Because the purpose of this restructuring of State Council Organizations was to streamline the administrative structure, the principle was to eliminate redundant organizations and merge organizations that did similar jobs. The aim was not to be completely rational or scientific. Consequently, although we can say that, compared with before, China's organizations for managing foreign trade progressed after the reforms, the following major structural defects persist:

1. Administrative levels are undifferentiated, jurisdiction is undifferentiated, and critical authority and responsibility are inconsistent with each other. Differentiation between vertical administrative levels and between jurisdictional ranks is an essential condition of effective management. The height of vertical administrative levels and management jurisdictions is often interrelated with the rectification of management responsibility. Any management system must be composed of at least three levels: the policy subsystem, the coordination subsystem, and the implementation subsystem. Currently the Ministry of Foreign Economic Relations and Trade is responsible for managing all levels of foreign trade, but as far as jurisdictional range is concerned, the two are out of sync with each other. In reality it is not within this ministry's power to make policies and coordinate them with corresponding major policies in other sectors. Under interference brought about when enterprises not under the Ministry of Foreign Economic Relations and Trade fail to break away from regional and hierarchical barriers, if the ministry is to be responsible for the volume of foreign exchange created, it can only put policies into effect under the principles of "blood kinship" or "nominal adoption." If the policies of the various industrial ministries are not coordinated with those of the Ministry of Foreign Economic Relations and Trade and other sectors, how can integration flourish between industry and trade and between production and marketing? And if such integration does not flourish, how can we control the growth of "poor" foreign trade?

2. Functions are undifferentiated and organizations are severely fragmented. From the perspective of current lateral-functioning organizations installed in China to manage foreign trade macroeconomically, the following points hold true: 1) In foreign trade we lack a strong macroeconomic advisory organization to act as a "brain trust" for policy-making organizations. The existing International Trade Research Institute primarily conducts surveys and studies market conditions. Besides this, it is a ministry-affiliated organization. And the Foreign Economic Relations Group of the State Restructuring of the Economic System Commission is too feeble. Consequently, neither of these is suitable to serve as an official macroeconomic advisory organization for foreign trade. 2) Up to now we have not formed any sensitive, accurate foreign-trade information organization at the state level to provide reliable information and feedback on policies and supervision. 3) The supervisory function is dispersed among various finance, banking, and foreign relations departments, and we have not yet formed an organic system for macroeconomic supervision of foreign trade. 4) Most important of all, we have no interdepartmental leading foreign trade organization or center that possesses policy-making, coordination, and control functions all in one.

3. As to the nature of the macroeconomic foreign-trade management organizations we have installed, leaving aside the official agencies, China has basically ignored

semi-official and nongovernmental managing and coordinating organizations. From the perspective of management theory, these three flaws in the installation of macroeconomic organizations for managing foreign trade have at the very least led to two major corruptions in this field in China: 1) We have no way to formulate a scientific policy-making procedure. 2) We have no way to formulate a rational procedure for implementing policy. Thus, this has led us to have no means of formulating unified, feasible policies or coordinated, effective management. During the planned economy phase this kind of backward macroeconomic management organization nevertheless was suitable to a certain extent because at that time enterprises had no production or operational autonomy. But as soon as we entered the planned commodity economy phase, particularly the unusual period when economic restructuring in China became major reform, due to the interaction of a series of factors—the assault of commercial economic forces, the expansion of enterprise autonomy, the large-scale reduction in direct management measures, the extensive adoption of indirect management measures, the transformation of new and old structures, and the special nature of economic actions in foreign trade—corruptions in this kind of organization multiplied day after day. Moreover, it placed greater and greater obstacles in the way of restructuring foreign trade and managing foreign trade macroeconomically.

1. Up until now we have produced no relatively comprehensive reform program, nor have we been able to formulate a comprehensive set of policies. If we formulate a foreign-trade reform program through the Ministry of Foreign Economic Relations and Trade—this single, specialized department—how can we produce an overall functioning system in which each sector can be exploited to the fullest? The result will be a lack of complementarity in planning and a lack of coordination in execution among financial, monetary, industrial, and foreign trade policies.

For example, prior to the implementation of the internal accounting system among public finance policies, foreign exchange rate policies, industrial policies, and import/export policies, public financial subsidies were not at all critical. Imports generally made profits which were used to subsidize exports. The internal accounting system was implemented to encourage exports, limit imports, and reduce losses on exports. But after it was put into effect, not only did losses on exports grow significantly, but import subsidies kept firmly abreast. This led to a high trade deficit in 1984. After we put a single exchange rate into effect, particularly after the renminbi foreign exchange rate inflated several times in 1985 and 1986, imports ran out of control. Subsidies on imports exceeded losses on exports and imports became the critical burden on public coffers. Thus, the more foreign trade developed, the more critical became the burden on public finances, and a vicious cycle of "impoverishment" took shape. The state went through successive years of dire fiscal and trade deficits.

2. Because we have been unable to coordinate the policies and interests of various sectors and regions, or because policy decisions themselves lack the necessary foundations, validity has declined, leading to a lack of policy stability. For example, one moment we are ignoring principal to ensure the target of creating foreign exchange, and the next moment we are controlling high deficits, strictly forbidding high deficit product exports, and indulging in arbitrary uniformity. For another example, before we worked out the relationships between industrial policies and foreign trade policies, during the great upsurge that accompanied the propagation of the new technological revolution, we stressed imports of advanced technology and high technology. We wished to improve industrial composition all in a single day, and as a result we built up a huge foreign trade deficit and foreign exchange ran out of control. Recently, under circumstances of major reductions in foreign-exchange reserves, we again stressed processing from materials provided and developing labor-intensive industry in order to create more foreign exchange. This vacillation between one extreme and another and back and forth on policy issues fully illustrates our lack of comprehensive, long-term goals, not only in reform efforts, but also in developing foreign trade.

3. Because our policy-making organizations lack authority, or because the policies themselves are not feasible, the implementation and execution of certain major policies often runs aground. For instance, it was announced that the export agent system would take effect in January 1985, but as of 1987 it there is still little trace of it. For another example, it seems as though from the beginning there has been no unified concept or objective, nor any comprehensive set of policy measures, for establishing an export production system. Yet such a system has already become an important orientation for restructuring foreign trade, and it has been written into the Seventh Five-year Plan. But as far as implementation is concerned, the export production system has also had very little effect.

## *II. Lessons Drawn from Post-War Foreign Organizations Set Up for Macroeconomic Management of Foreign Trade*

A comparison of foreign trade management systems in key nations worldwide shows that "comprehensive coordination, centralized policy-making, and management by the appropriate sectors" are becoming the guiding ideology for developing macroeconomic management of foreign trade in the present age. Some countries, such as the United States, that most advocate decentralized policy-making and management, are also edging closer to this route of macroeconomic foreign trade management.

The principle of relatively centralized management—with comprehensive coordination as its nucleus and centralized policy-making and management by the

appropriate sectors as its two sides—took shape worldwide in the postwar period as the theory of macroeconomic management of foreign trade, and was put into practice as a new developmental trend. The reason this was possible was not merely historical chance, but the principle's rational foundation for development. Due to the intensification of international competition, which is interwoven of vertical and horizontal competition, it has become common practice in every country to draw support from state power or even to adopt the power of state-run trade measures. Because centralized policy-making and management by the appropriate sectors are built upon a foundation of "action through knowledge" and horizontal cooperation among the respective systems, from the perspective of systems theory this method both avoids the drawbacks of centralized and decentralized policy-making—bureaucratism and departmentalism—and makes use of their advantages—at the same time as it reduces risks, it achieves the optimum overall objective. From the perspective of longitudinal control theory, under the guidance of this kind of management ideology, macroeconomic management has only added policy-making levels, and executive bodies in every state channel still wield the various policies produced through policy-making (with economic laws and regulations as the key force) to control microeconomic enterprises indirectly. Moreover, under this perspective macroeconomic management has not added control levels: microeconomic enterprises each have their respective control organizations. This is precisely because after decentralized controls are put into force, most of the powers directly related to enterprise production and operation are transferred to independent microeconomic control organizations. So as to strengthen the effectiveness of macroeconomic control, the state must be very careful with the limited macroeconomic policy-making powers that remain. Consequently, we should say that, insofar as possible, this kind of macroeconomic management also avoids the drawbacks of centralized and decentralized controls, and it simultaneously exploits the advantages of both.

In order to guide and ensure that this ideology of macroeconomic foreign trade management was achieved, in the postwar period all major countries with developed foreign economic policies, as well as all those who sought to improve foreign economic management, one after another reformed their rationales for policy-making procedures and policy implementation processes. Their basic method began by installing macroeconomic management organizations in a more rational way. This was primarily expressed in the following four ways:

1. By merging departments and expanding powers, they achieved comprehensive coordination, centralized policy-making, and management by the appropriate sectors.

For example, after the Yoshida cabinet was formed in 1949, Japan, which is a "nation founded on trade," merged the Ministry of Commerce and Industry and the Department of Trade into the Ministry of Trade and

Industry. Afterwards, under the provisions of the "Ministry of Trade and Industry Installation Act" formulated in 1952, the central government vested this ministry with the authority to implement centralized control over foreign trade. At that time the Ministry of Trade and Industry had jurisdiction not only over domestic trade, but also over all production enterprises and all resources used in production. It also had the power to manage all foreign exchange, commercial inspection, and customs controls related to foreign trade. We should say it possessed the basic conditions necessary to accommodate major policy-making and implementation organs. Of course, Japan also relied on other important macroeconomic foreign-trade measures to round out the set.

For another example, the federal government of Canada, which has had a basically favorable balance of trade since the 1960's, has vested authority for macroeconomic foreign trade management chiefly in the Ministry of Industry, Trade, and Commerce. This ministry was formed in 1969 by merging the original Ministry of Commerce and Trade and Ministry of Industry.

For a further example, in the Federal Republic of Germany, whose exports account for about 10 percent of the gross value of world export trade, the Ministry of Economics, which is responsible for foreign trade, is a composite organization. Its range of responsibility includes industry, commerce, energy, mining, foreign economic affairs, foreign trade, and so forth.

2. They achieved comprehensive coordination and centralized policy-making by establishing additional organizations with interdepartmental authority.

The U.S. Trade Policy Commission and the Office of the Special Trade Representative are examples of this. The United States' competitiveness in foreign trade and its foreign balance of trade have been declining since the 1970's. The U.S. government and many high Congressional officials have pointed out that the deteriorating U.S. position in international trade is related to its decentralized system for managing foreign trade. Authority for macroeconomic management of foreign trade in the United States is dispersed among dozens of federal government departments. Thus, there are too many affairs to handle and too many administrative offices involved. Everyone's hands are tied, policies vacillate back and forth, and efficiency is low. For this reason, in January 1980, in accordance with the "Export Control Act" passed by Congress in September 1979, major reforms were carried out in the federal departments responsible for foreign trade. The reforms made clear that the policy-making body is the Trade Policy Commission, the coordinating body is the Office of the Special Trade Representative, and the primary executing body is the Department of Commerce.

Although the U.S. Trade Policy Commission was established as early as 1957, at that time its policy-making powers were limited. It was chaired by the secretary of



commerce, and it had little interdepartmental function. But after 1980 this commission became an interdepartmental government policy-making body in fact as well as in name. It is chaired by the special trade representative and the vice-chairmanship is held by the secretary of commerce. The membership is composed of heads and officials from the Departments of State, Agriculture, Treasury, Defense, Interior, Energy, Transportation, and Labor, the Import-Export Bank, the Overseas Private Investment Corporation, the Small Business Administration, the National Security Council, the Office of Management and Budget, the Agency for International Development, the President's Council of Economic Advisors, and the Department of Justice. The chairman of the International Trade Council is an observer. Under the Trade Policy Commission there are two additional interdepartmental organizations—the Trade Policy Examination Committee (the chairman is the assistant U.S. trade representative, the vice-chairman is the assistant secretary of commerce, and the membership is composed of the assistant heads and officials of member departments in the above Trade Policy Commission) and the Trade Policy Work Committee (the chairman is the assistant to the U.S. trade representative and the membership is composed of experts from among the member departments of the Trade Policy Commission discussed above).

The U.S. Office of the Special Trade Representative was formed from reforms in the Office of the Special Trade Representative to the 1962 U.S. Trade Talks. At that time this office was created to check the narrow inclination for each specialized sector to insist on its own way when approaching or handling multilateral or bilateral world trade talks. The special representative to the trade talks was appointed by the president and the Senate and held privileged ambassadorial rank. Then, after 1980, the U.S. Office of the Special Trade Representative rose from privileged ambassadorial rank to cabinet rank, and the range of its jurisdiction was expanded from negotiations on international trade agreements to the formulation and coordination of overall foreign trade policy. The special trade representative, assistant trade representative, and assistant to the special trade representative respectively head the above three trade policy-making commissions. They also unify policy-making and coordinating bodies through their authority. Another assistant trade representative is often stationed in Geneva to participate with "GATT" general headquarters in settling international affairs. Thus, the U.S. Office of the Special Trade Representative has finally become the president's actual delegated representative in foreign trade, as well as the White House's delegated body for centralizing and coordinating foreign trade policy.

Recently, Soviet organizations for macroeconomic management of foreign trade have implemented similar reforms. In order to enhance macroeconomic management, the Soviet Union's Council of Ministers installed a State External Economics Commission. The members of

this commission include officials from every major sector concerned with foreign economic affairs, and the chairmanship is assumed by a deputy chairman of the Council of Ministers. Thus, it is helpful for centralizing and coordinating foreign trade relations between various sectors.

3. They improved the validity, feasibility, and coordination of policy-making by establishing strong advisory bodies.

In order to vitalize exports and promote economic development, as early as 1954 Japan set up an interdepartmental Prime Minister's Residence Supreme Export Council. In 1964, in accordance with the "Prime Minister's Residence Installation Act," reforms were carried out in the export council. The chairman of the council was the prime minister, the vice chairman was the minister of trade and industry, and the membership was composed of chief officials from nine departments—the Ministry of Foreign Affairs; the Ministry of Finance; the Ministry of Health and Welfare; the Ministry of Agriculture, Forestry and Fisheries; the Ministry of Transportation; the Ministry of Construction; the Economic Planning Agency; the Bank of Japan; and the Export-Import Bank of Japan; as well as drawing upon representatives of comprehensive commercial societies, exporting firms, and economic trade experts. In 1970 the Export Council became the Trade Council, and the scope of its affairs and policies was expanded from exports to combined exporting and importing. More and more officials from professional associations were enrolled in its membership. This coordinated and unified government leaders, foreign trade and related departments, nongovernmental entrepreneurs, and economic and trade experts on the various aspects of comprehensive and long-term trade policies.

In 1979 the United States established the President's Export Council, composed of 40 members. The membership includes seven cabinet-level members (the special trade representative, secretary of state, secretary of agriculture, secretary of labor, secretary of the treasury, and president of the Import-Export Bank), six congressmen, and 27 representatives from the private sector. Its function is to propose to the president major measures that should be adopted in U.S. export policies or concerning export expansion, as well as to coordinate the departments concerned.

4. They helped the government put centralized foreign trade policies into effect by establishing many semiofficial and nongovernmental organizations to coordinate management.

In addition to official departments, which are the chief organizations responsible for executing foreign trade policies, most western governments also establish many semiofficial and nongovernmental management organizations to assist official agencies, and together they implement the government's foreign trade policies.



Their primary task is to coordinate relations between government and enterprise, relations among industries, and relations among enterprises within each industry. Thus, primary and secondary coordination between the various official departments executing foreign trade policies, as well as between the official and the semiofficial and nongovernmental management organizations, which are very different in character, ensure that the government's centralized macroeconomic policies for foreign trade management are effectively carried out through a network of management coordination. This macroeconomic style of managing foreign trade, coordinated in every direction, has been carried out in an outstanding fashion by the Japanese. Some other organizations that have been quite successful in this area include England's Overseas Trade Commission and its 16 regional trade associations in different countries, France's Foreign Trade Center, and Italy's Foreign Trade Association.

### *III. Measures for Reforming China's Organizations for Macroeconomic Management of Foreign Trade*

Based on the foregoing analysis, reforms in China's organizations for macroeconomic management of foreign trade should first be divided into the following two steps:

Step 1: Right now, given the precondition that it should not fundamentally affect overall macroeconomic management organizations, in as short a period of time as possible we should establish two authoritative interdepartmental agencies. One should be an interdepartmental advisory agency concerned with foreign currency, which we might tentatively call the Foreign Trade Policy Commission. The chairman should be a vice premier in charge of foreign economic affairs and trade, the vice chairman should be a vice minister in the Ministry of Foreign Economic Relations and Trade, and the membership should be composed of various vice ministers and members in the departments concerned and some experts on foreign economic relations and trade. Its duties should be to discuss, draft, and revise our principle foreign trade policies.

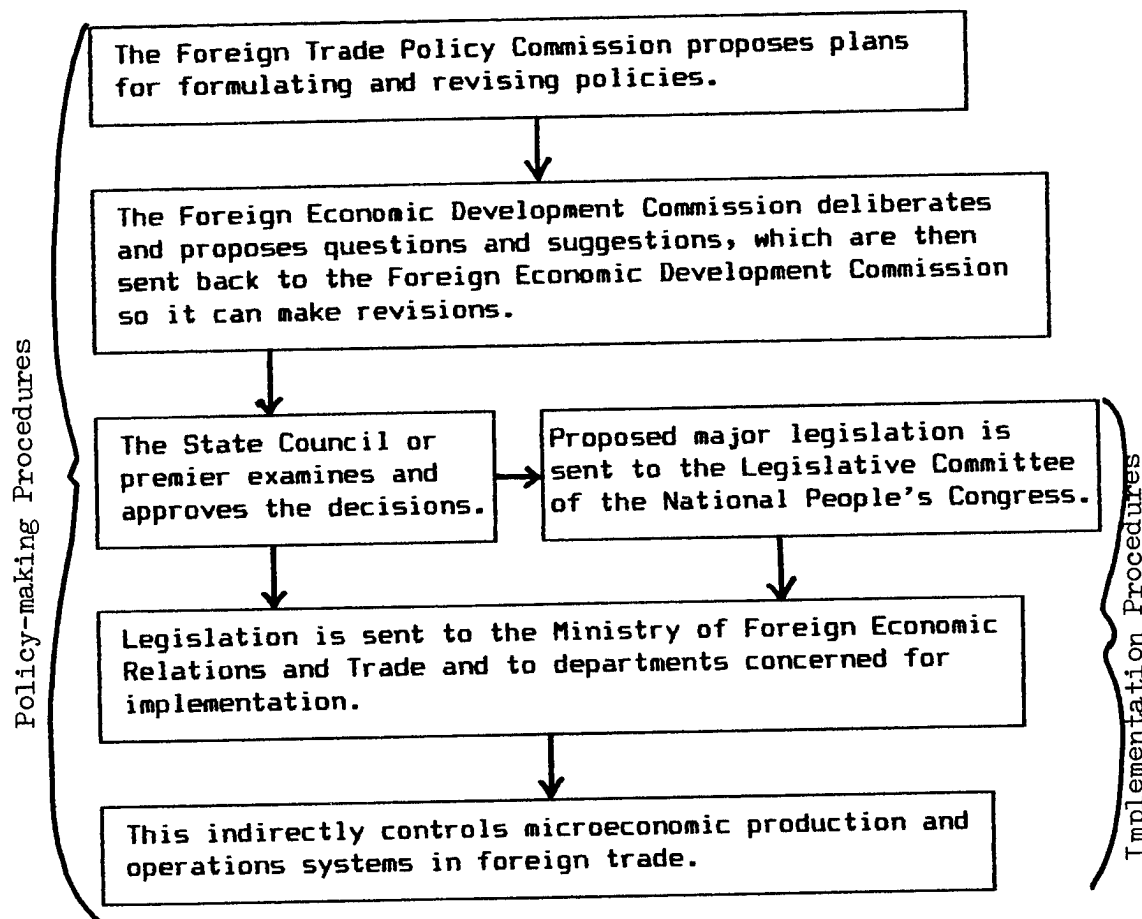
The other should be an interdepartmental foreign trade policy-making agency, which we might tentatively call the Foreign Economic Development Commission. The chairman should be the premier of the State Council or a State Council vice premier in charge of foreign economic relations and trade. The vice chairman should be the minister of foreign economic relations and trade, and the membership should be composed of the ministers and members of the departments concerned. Its duties should be to deliberate, coordinate, and decide on major foreign policies, and to be responsible to the State Council or the premier.

These two major agencies, headed by the government and composed of a combination of responsible departments, interrelated departments, and experts, will respectively function as the final decision makers, expert

managers, and coordinators. From the management perspective, this will help to keep authority and responsibility consistent with each other and to coordinate fundamental unification. Thus, because there will be a foreign trade advisory organization, a foreign trade policy-making organization, and a foreign trade coordinating organization, (with the two existing concurrently, the foreign trade advisory organization will form the elementary level of coordination and the foreign trade policy-making organization will form the senior level of coordination), and because it will be clear that the Ministry of Foreign Economic Relations and Trade is the chief agency for foreign trade policy making and policy execution, we can fashion basically realistic and effective decision-making and policy-implementation processes for macroeconomic management of foreign trade. For example, this may be charted as follows:

Step 2: At the appropriate time (we may consider the latter half of 1988, after the 13th Party Congress of the CPC) we should undertake a comprehensive reform of the nation's system of macroeconomic management organizations. These reforms should encompass the following areas: 1) The various ministries of industry should be merged into a Ministry of Industry; 2) The Bureau of Customs and Commercial Inspection, the Bureau of Foreign Exchange Management, the Ministry of Commerce, and the Ministry of Foreign Economic Relations and Trade should be merged into a Ministry of Economic Relations and Trade; 3) We can specially establish a foreign economic and trade information agency and a supervisory agency to handle foreign trade information and supervision and feedback measures that are now dispersed among various departments; 4) We should set up all sorts of semiofficial and nongovernmental coordinating and managing organizations; 5) The internal structure of our organizations should be made more rational; 6) We should reform our system for appointing managers in macroeconomic management organizations. I suggest we change the appointment system to a testing system or a testing and merit system.

Analyzing matters from a management perspective, enhancing primary and secondary coordination among government leaders, expert management departments, and interrelated departments; among official, semiofficial, and nongovernmental management organizations; among the various relationships within management organizations; and between centralized control and decentralized control will ensure that China can also achieve success the world has experienced through "comprehensive coordination, centralized policy-making, and management by the appropriate sectors." It will also ensure that we can vigorously promote reforms in overall macroeconomic management organizations, we can pursue economic restructuring, and we can promote economic development in China.



**CASS Economists Promote Countertrade**  
40060123 Beijing CAIMAO JINGJI [FINANCE AND  
TRADE ECONOMICS] in Chinese No  
12, 11 Dec 87 p 60

[Article by Jia Suying [6328 5685 3379] and Ma Yuanhe [7456 0337 7729]: "Measures to Promote Countertrade"]

[Text] Countertrade has made a comeback in the international economic arena in recent years. While the reviews have been mixed, it has attracted the attention of more and more countries as a supplementary means to promote international trade. We should study this form of trade in light of China's realities and explore avenues of developing it in order to expand exports and further foreign economic relations and trade.

The revival of countertrade in the world is closely related to changes in the international economic situation. Since the mid-1970's, the world economy has entered a period

of slow growth and opportunities for trade expansion have shrunk. Under these circumstances, trade protectionism flourished and tariff and non-tariff barriers of all descriptions proliferated, to the detriment of the growth of international trade. It was against this backdrop that countertrade emerged as a way to get around the myriad trade barriers. Another boost to the rise of countertrade was the fact that developing nations, for whom economic growth is an uphill struggle, were looking for a way out of the old international economic order.

Countertrade is a catchall term for a multitude of trade practices combining export and import. Any transaction in which the exporter is required to commit itself to purchasing goods and services in return from the importer or to selling such goods and services for the importer is generally referred to as countertrade, as are arrangements under which both the exporter and the importer pay off loans with goods. Tangible forms of

countertrade usually include barter trade, compensation trade, mutual-purchasing trade, resale trade, trade on credit, and triangle trade.

Compared to regular trade, countertrade has its own characteristics. It combines export and import, with the latter driving the former. It is a supplement to and makes use of the tools of regular trade such as negotiations, contract signing, delivery, and payment, only more flexibly. In countertrade, the payment period may be long or short. Free foreign exchange may be used directly or indirectly. There may be direct barter trade. Also, countertrade can extend to the area of production. Participants in countertrade include not only trading companies and financial institutions, but also production enterprises. Compared to regular trade, countertrade involves more complicated formalities, covers a wider scope, incurs more expenses, and has relatively low returns. Moreover, it is subject to disruption by all manner of emergency and is quite risky. In the short run and for some time to come, however, we cannot overlook its stimulating effects on international trade and the economies of all nations.

The resurgence in countertrade has provided a new opportunity for the development of China's foreign trade. By making full use of this opportunity, we may expand our exports by accelerating the transformation of the nation's export mix in the direction of multiple processing and increasing high value-added products; relieve the existing and future foreign exchange shortage; expand the import of equipment and raw materials urgently needed in construction; improve China's long-standing trade imbalances with some nations and regions; contribute to the diversification of our exports; encourage industry-trade and technology-trade integration and enterprise technological transformation, and promote foreign trade reform and steady import and export growth.

Still in its infancy, countertrade in China faces many obstacles. Most sectors in the nation do not fully understand this form of trade and are even prejudiced against it. In China, export is divorced from import, with different people managing the two. Foreign exchange needed to pay for imports comes from government appropriations, while foreign exchange earned by exports is turned over to the state. We are a major importer, yet our leverage as an importer is not effectively exploited. Foreign trade planning is too rigid. The examination-and-approval procedures in countertrade are overly cumbersome. All this combines with the lack of information to gravely hamper the growth of countertrade. To make the most of this form of trade, and with the existing problems in mind, we should tackle the following successfully without delay:

First, formulate a feasible and practical countertrade policy, including preferential policy, import and export mix policy, and import and export management policy, among others. The preferential policy should exempt

imports and exports from tariffs and allow exporters to retain a specified portion of foreign exchange earned. Concerning the import and export mix, technology imports and technological transformation projects should be included in countertrade in addition to the regular commodities in order to spur China's exports. Provided they increase exports, these projects should be given preferential treatment in taxation and credit. Turning to import and export management, commodities within the state import and export licensing system, particularly those that will boost exports, should be treated preferentially in the issue of licenses. It is also proposed that formalities be simplified as appropriate.

Second, the countertrade management system should be overhauled. The existing trade coordination group in the Ministry of Foreign Economic Relations and Trade [MOFERT] has a limited jurisdiction. What is lacking is an agency specializing in countertrade management. It is suggested that the State Council authorizes MOFERT to establish a countertrade office to coordinate the countertrade functions of all ministries and commissions at the center as well as provinces and municipalities and, in consultation with the legislation departments of the State Council and MOFERT, prepare legislation and detailed implementation regulations pertaining to countertrade in order to advance countertrade nationwide.

Third, we should open up countertrade with all nations on the basis of equality and mutual benefit. But while our approach should be universal, we should concentrate on nations with which we have large trade deficits and choose countertrade partners properly based on the commodities. We also must be careful to avoid price-slashing and cutthroat competition so as not to disrupt existing sales channels and markets.

Fourth, departments in foreign trade, agriculture, industry, banking, insurance, transportation, customs, information, and consulting should cooperate with one another closely and strive together to bring about a breakthrough in countertrade.

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#### **Issues in Border Trade Reevaluated**

40060078 Beijing GUOJI MAOYI WENTI  
[INTERNATIONAL TRADE JOURNAL] in Chinese  
No 5, 1987 pp 54-57

[Article by Liu Ruijin [0491 3843 6855], graduate student at the College of Foreign Economic Relations and Trade]: "A New Understanding of a Number of the Issues Involved in China's Border Trade"]

[Text] China is a vast nation whose land border totals more than 21,000 km and which is bounded by 12 countries: the Soviet Union, Mongolia, the Democratic

People's Republic of Korea, Pakistan, India, Afghanistan, Nepal, Bhutan, Sikkim, Burma, Laos and Vietnam. Thus China enjoys favorable conditions with which to develop her border trade.

Having traversed a tortured course, China's border trade is now on the right track. To date, we have initiated such trade with the Soviet Union, Mongolia, the Democratic People's Republic of Korea, Burma, Pakistan, Nepal and other nations, and this trade has expanded rapidly and become an important component of our general strategy of opening up to the outside world.

Nevertheless, because this trade has been low volume, is constrained by the political relations between countries and has fluctuated up and down, we have never stressed or studied it enough and thus do not fully understand it. As this trade increases in importance in our economic strategy of opening up to the outside world, I believe we must reexamine from a theoretical perspective a number of related issues so as to gain a proper understanding of that trade.

#### I. New Developments Have Occurred above and beyond Traditional Border Trade

A. The concept of border trade has been expanded. The traditional definition of this trade is as follows: "Border trade is trade that is conducted on the frontiers between neighboring nations so has to meet the needs of the residents of frontier regions. This trade, also known as low-volume frontier trade, which permits inhabitants of both sides (usually 15 km on each side) of an international border to maintain free contacts and to exchange a limited volume of specified commodities, arose out of traditional custom and is normally accorded such preferential treatment as reductions in or exemptions from customs duties and simplification of customs formalities, which privileges, however, cannot be applied to third nations, a stipulation that stands as an exception in cases where most-favored nation is granted." (See "Yinghan guoji maoyi yu jinrong cidian" [The English-Chinese Dictionary of International Trade and Finance] [editor in chief, Professor Wu Yongxun [0702 3057 3800]] and the definition supplied in the "Cihai, Jingji fence" [Sea of Words, Volume on Economics]).

Nevertheless, given the recent developments in China's border trade, the traditional conceptualization must be expanded. At present, our border trade takes the following principal forms.

First is shared-market trade for inhabitants of border regions. This trade, in consideration of traditional custom and practical need of inhabitants on both sides of our borders to exchange goods and materials, permits those inhabitants to trade, in accordance with the principle of "supplying each other's needs and adjusting surplus and dearth," a limited volume of commodities at designated markets on the Chinese side of the border.

Second is low-volume trade. This is conducted with businessmen of neighboring countries on a non-governmental, barter basis by shops established by authorized state or collective industrial and commercial enterprises. Under such an arrangement, each side prices its purchases itself, computes exports as imports and strives to maintain a basic balance in the trade.

Third is border-town trade, which is conducted between frontier cities and towns in our country and similar entities across the border.

Fourth is local trade. This is conducted by frontier import-export companies with similar entities on the other side of the border and is official in nature.

From the above list, it is apparent that transactions conducted under the traditional conceptualization account for only part of our current border trade, namely shared-market and low-volume trade. Current trade involves much more than the traditional practice.

B. Border trade has been broadened in geographical scope. In general, border trade used to be restricted to areas within 15 km of both sides of our borders, but today that trade has been expanded to include imports and exports between entire regions, and even their hinterlands, on both sides of the border. For example, the border trade conducted by our region of Tibet has been extended to include all of Nepal's capital city of Katmandu. In addition, according to a report dated 4 October 1986 by the Jiji News Agency of Japan, in consultations held in August of that same year, Nikolay V. Talyzin, deputy chairman of the USSR Council of Ministers, and Chinese leaders reached an agreement to expand border trade between China and the Soviet Union to include the interior of both nations. The Chinese side, according to the report, agreed to expand the scope of this trade beyond Heilongjiang Province, the Inner Mongolia Autonomous Region and the Xinjiang Uygur Autonomous Region—regions bordering on the Soviet Union—to include Jilin Province, the Ningxia Hui Autonomous Region and Qinghai Province. Clearly, border trade is no longer confined to areas within 15 km of our borders but has been gradually extended into our interior and the hinterlands of our neighbors.

C. The forms and content of border trade have increased. In terms of form, in addition to the traditional shared-market and low-volume trade, we have also developed border-town, local border, border compensation, triangular border trade and a flexible variety of other forms of trade. In terms of content, we have advanced beyond mere visible trade to include such things as technological trade, joint ventures, cooperation in the field of labor services and economic, technological and cultural interchanges.

#### II. The Characteristics of Border Trade

Although border trade is one category of local trade, it differs from the latter in several ways.

A. The two types of trade differ in terms of the preferential treatment with which they are accorded. Border trade is a special form of local trade. As a complement to international trade, border trade is low volume and enjoys much more favorable treatment in terms of customs duty abatements and exemptions and simplification of customs formalities. Local trade, on the other hand, must be conducted in accordance with commercial treaties and trade agreements signed between countries and cannot claim the favorable treatment accorded to border trade.

B. Border trade is more political in nature than local trade. For China, border trade is not only part of the state's foreign trade but also forms part of our trade with other peoples. Objectively speaking, border trade bears responsibility for two very important political tasks and gives expression to our country's domestic and external policies. As early as August 1951, Comrade Chen Yun, in a report on financial and economic conditions to the National Conference on Trade with Other Peoples, stated that "trade with other peoples is an important link in our relations with other peoples." He exhorted workers in trade with other peoples to avoid treating this trade purely as a form of business, and told these workers that their work was a concrete embodiment of China's policy on her relations with other peoples, that these workers were executors of that policy and that these workers must in their economic work shoulder the tasks of uniting with fraternal peoples and of consolidating national defense. From this report it is apparent that China's border trade is responsible both for implementing our country's policy on its relation with other peoples and for strengthening our traditional friendship with the people of neighboring countries. Thus border trade is a concrete manifestation of our policy on relations with other peoples both at home and abroad and is very political in nature.

C. Border trade is much more susceptible than is local trade to constraints resulting from changes in the political climate in the relations between China and her neighbors. As everyone knows, tension in the political relations between two nations is bound to give rise to antagonism in the border regions between the two countries. Such antagonism, or social unrest in one of the countries' border regions, will force the nations to close the doors to their border regions, which move will bring border trade to a stop. Shared markets for border residents are especially susceptible to the effects of the political climate.

D. Border trade is much more difficult to conduct than is local trade. Border regions face many more disadvantages in their efforts to conduct border trade than do regions in the interior in their conduct of foreign trade. For example, border regions are remote, transport in these regions is poor, their natural environments are

complex, they do not have good access to news and information, their economies are backward, and the social, political and economic conditions in the regions lying across the international border are very complex. All of these factors impede development of border trade.

### III. The Role of Border Trade Should Not Be Underestimated

In the past, border trade was generally seen as serving mainly to meet the needs of border inhabitants and to increase traditional friendly ties between these inhabitants and the people of neighboring countries. This understanding is correct, of course, but I believe it is incomplete. For with the increasing strategic importance of China's policy of opening up to the outside world and the growing economic needs of our border regions, border trade is starting to play greater and greater roles. In addition to the two roles enumerated above, border trade is beginning to function in the following capacities.

#### A. Microscopically

1. The development of border trade has greatly increased the domestic and foreign economic ties of border regions, opened the doors of these regions, eroded the traditional stress on self-sufficiency championed by natural economic thought, stimulated reform throughout the societies and economies of border regions and enlivened the commercial economies of these regions, all of which developments have helped to "invigorate the border regions and enrich their inhabitants." China's border regions are the main dwelling places of her minority nationalities. Fettered by their traditional customs and ideologies, these nationalities once found business shameful, stressed righteousness and disparaged profit, were content with self-sufficiency and had no notions of commercial economy and competitive spirit. All of these tendencies seriously impeded commercialization in these regions and contravened the principle that "all businesses should be invigorated." The expansion of border trade, however, greatly changed this state of affairs. For example, the people of our border region of Tibet used to find business shameful, were accustomed to barter trade and had no notions of commodities or money. But with the expansion of this region's border trade over the past few years, exchange has grown considerably, and this has stimulated expansion of industrial and agricultural output, enabled Tibetans to taste the benefits of commercialization and given rise to the phenomenon of the "three mores," that is, more people engage in business, more households specialize in transport and more people want to purchase automobiles and tractors. For example, in the town of Zhangmu, one of Tibet's new entrepôts, there are 190-some households, 106 of which, or 56 percent of the total, had obtained business licenses as of June 1984 and have reported holding 1.20 million yuan in capital. Several tens of people from this town have also carried their trade as far

as Katmandu. These developments have increased the incomes of local inhabitants, made the markets of these localities flourish and invigorated the commercial economies of these areas.

2. The growth of border trade has facilitated readjustment of the irrational economic and productive structures of border regions. Long influenced by "leftist" thought, these structures had become very irrational. In agriculture, forestry and animal husbandry, the main economic sectors of these regions, production was monolithic, and there were sectoral dislocations. Expanding border trade and increased economic and technical exchanges with domestic units and foreign countries, however, brought about expansion in the markets of these regions; greater inflows of technology, raw materials and information; and thus helped bring production and management in these regions into alignment with market demand. These are precisely the kinds of things that are required by economic law. For example, the Dehong Dai Autonomous Prefecture of Yunnan has greatly expanded its border trade with Burma. Between January and October of 1985, 3,089 new industrial and commercial households were registered, and these employed 4,196 persons. Now there are 8,273 such households employing 11,417 persons. Of these households, 5,896, employing 8,034 persons, are engaged in trade; 481, employing 733 persons, are engaged in handicrafts; 373, employing 456 persons, are engaged in service industry; 455, employing 538 persons, are engaged in transport; 698, employing 1,074 persons, are engaged in catering; 258, employing 326 persons, do repair work; and 64, employing 209 persons, are engaged in construction. These developments have transformed the monolithic economic and productive structures of the past and made these structures more rational.

3. The expansion of border trade has facilitated transformation of advantages in natural resources into economic advantages. China's border regions possess an abundance of natural resources but, due to limitations imposed by natural conditions, have never been able fully to exploit these resources. Thus the key to economic development in these regions is determining how to exploit their rich natural resources and to enhance the vitality of their economies. Border trade has a complementary nature to it. That is, we trade things we have in abundance for those we lack, and we export products we possess in abundance for resources, products and advance technology and equipment we urgently need in production or in our daily lives. Therefore, border trade not only provides markets in which to sell the industrial and agricultural goods border regions possess in excess supply or cannot self off, but also provides supplies the raw materials and technology the regions urgently need. Thus border trade facilitates expansion in border regions' industrial and agricultural productive capacity, increases in the regions' labor productivity and economic returns, and transformation of resource advantages into economic advantages.

4. Border trade helps increase revenues of local governments and thereby reduces the fiscal burden of the state in supporting those governments. The growth of border trade has made the commercial economies of border regions more vigorous than ever before, enabled market supply and sales in these regions to flourish and thus undoubtedly has increased local revenues. For example, in Dehong Autonomous Prefecture, Yunnan, tax reform and declines in cane sugar production reduced local revenues from these old sources by 7.18 million yuan in 1985. Nevertheless, the opening of border trade that same year caused the local government's revenues from commercial taxes to increase greatly, and combined with increases in revenues from other taxes, this enabled the prefecture's revenues during the month of November to reach 33.29 million yuan, 114.8 percent of the planned target for the entire year, and a rise of 1.91 million yuan over the level of 31.38 million yuan for the same period the previous year. This development brought a turnaround in the previous passivity of the prefecture in terms of finances.

5. Border trade promotes urban development in border regions. Border trade makes the cities and towns involved in this trade prosper and thrive. Contacts with cities and towns on the other sides of our borders enable our border regions to exchange ideas with and learn from the other side in such areas as urban administration and development. Economic and technological cooperation with cities and towns on the other side of our borders will promote economic development in the cities and towns of our border regions.

#### B. Macroscopically

1. Border trade facilitates expansion of China's trade channels, reduces overcentralization in our foreign economic and trade relationships, which situation is disadvantageous, and pluralizes those relationships.

2. Expansion of border trade with neighboring developing countries and increasing our economic, technological and cultural exchanges with these countries are important elements in China's policy of "cooperation among nations of the South" and will help expand our influence among those countries.

3. Border trade increases border regions' capacity for self-sufficiency and helps reduce the state's financial subsidization of and allocation of goods and materials to these regions. This both alleviates tie-ups in our transport system and greatly reduces costs.

4. Border trade helps strengthen our friendly ties with the peoples of neighboring countries, enhance mutual trust between us and our neighbors, consolidate our national defense and create a stable and peaceful environment for the sustained and balanced growth of our economy and for our efforts to double national economic output.

The above discussion represents a new understanding of some of the problems related to our border trade. Due to the author's limitations, these views remain very immature. Our border trade has already begun to fly and enjoys bright prospects. Of course, there are many new problems in this area that await further study. Thus it is urgent that we strengthen our study of border trade.

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**Fujian's Foreign Debt Management Discussed**  
40060060 Fuzhou FUJIAN LUNTAN in Chinese  
No 9, 5 Sep 87 pp 31-33

[Article in column entitled "Fujian Economic Development Studies" by Liang Longjun [2733 7127 0193] from the Finance and Trade Bureau of the Fujian Provincial Committee Office: "Some Thoughts on Fujian's Use of Foreign Credit"]

[Text]

**I. Determine the Proper Amount, and Increase, of Foreign Debts**

Setting an appropriate foreign debt level and increasing it at an appropriate rate are crucial if we are to prevent debts from getting out of hand.

What is an appropriate debt level, and how do we control its rate of increase? Often people discuss these issues in the context of the nation as a whole, but here we are referring to a single province. Generally, after making some necessary corrections to suit local conditions, the standards which determine a nation's proper foreign debt level and its increase also apply to a province. I think that the overall amount and the increase of foreign debt basically depend on Fujian's actual economic strength, and specifically, the following factors:

1. *Ability to repay foreign debt.* Timely repayment of foreign loan principal and interest is the obligation of all debtors. Therefore, in determining the amount and the increase of foreign debt we must first ascertain our ability to repay, and especially consider the following factors: (1) Fujian's export volume and its growth rate over time; (2) the amount, and the increase, of foreign exchange from nontrade sources; (3) the demand, and increase in demand, for imports; (4) the amount and the increase of nontrade foreign exchange payments; (5) the international interest rate and exchange rate, and their future trends. Generally, the interest rate and the debt level should not rise faster than the increase in foreign exchange income from exports and nontrade sources on a sustained basis. In addition, Fujian's ability to set up an effective foreign debt management and adjustment mechanism in the near future is also an important factor.

In recent years, Fujian's total foreign debt amount has increased rapidly; it doubled between 1984 and 1985, and doubled again between 1985 and 1986. At the same

time, total output value increased 19.2 percent in 1985, and 9.6 percent in 1986, while income from exports increased at a rate of 16 percent in 1985, and 17 percent in 1986. The debt level has risen much faster than the province's total output value and income from exports. Although Fujian's foreign debt base is low, this trend of rapid rise deserves our attention.

2. *The economic gains of utilizing foreign credit.* The economic gain from the use of foreign credit (especially in terms of foreign exchange) is what guarantees repayment of foreign loans and interest. Whether we are talking about a single project or the overall situation, only if we have balanced foreign exchange can we continue to use, or increase the use of, foreign credit. Therefore, when we proceed to borrow foreign funds we must conduct thorough feasibility studies on each contemplated project, and measure the microeconomic gains. We must also comprehensively measure the possible economic benefits of all projects in the province which are funded by foreign credit, to make sure that we can meet principal and interest payments, lower the cost of utilizing foreign credit, and ensure their long-term and steady use. This mandates that most foreign credit be used on export-oriented projects which bring in foreign exchange or on projects that are technologically advanced and provide substitutes for imports. In this way we may achieve an overall foreign exchange balance. Up to the end of 1986, Fujian's foreign credit was mainly used on the following types of projects: 13.9 percent on infrastructure projects, 78.9 percent on production type projects, (foreign credit is mainly used to import raw and auxiliary materials needed by enterprises,) and 7.2 percent on service type projects. Most of these projects were domestic type projects or import substitution projects where the use of RMB would have been more beneficial. The failure to balance foreign exchange is already a serious problem today.

3. *The ability to absorb foreign debt and the accompanying imported technology.* Foreign credit utilization is effective and economically beneficial only if we have the ability to absorb and internalize it. This ability depends on many factors, mainly: (1) whether we have sufficient RMB to match the borrowed funds; (2) whether we have the resources and productive force at our disposal, including the supply of energy, capital goods and raw material, and a full line of products to accommodate and satisfy the need of the construction and projects funded by foreign credit; (3) whether we have the ability to absorb the technology brought in by foreign credit; (4) whether we have the personnel, know-how, and experience to build and manage these projects.

An analysis of the above factors show that in the next 10 years, Fujian should limit its additional foreign debt to around \$600 million in order to keep the loan repayment within safe boundaries. This is because: (1) the overwhelming majority of the available foreign exchange in the province is used on importing industrial and agricultural raw material and auxiliary material, as well as

equipment, technology, equipment, and consumer goods (these imported items accounted for 61.55 percent of Fujian's total foreign exchange expenditure last year,) and it is unlikely that imports will reduce drastically, nor will exports increase significantly in the near future. (2) We have little ability to absorb and internalize foreign debt, and we have yet to see better economic results in using foreign credit. (3) Our foreign debt management system and adjustment mechanism are weak and unresponsive. Therefore, Fujian should rely mainly on domestic funds for its economic construction projects, and use foreign credit only as a supplement.

## II. Establish a Rational Foreign Loans Structure

The structure of the loans affects the economic and social benefits of the Fujian's credit utilization, and it also affects our ability to repay the loans. The main problems in the existing structure are: one, a rising proportion of commercial loans; two, a significant increase in short-term loans; three, a limited number of lender countries and markets; four, a limited variety of currencies. Given these conditions, the way to set up and improve this province's loan structure is described below.

1. *The mix of sources of funds.* We have two major kinds of loans: first, funds borrowed from foreign governments and international financial organizations; these are the governmental sources. The other kind is the commercial loan in the international financial market, including the issuance of international bonds, and they make up the commercial source.

Up to the end of 1986, 15.03 percent of the balance of our foreign debt was a result of governmental loans (not including foreign exchange loans from the Central Bank while 84.97 percent was a result of commercial loans. A few years ago, governmental sources made up the bulk of the foreign loans, and commercial loans accounted for only a small portion. But in the past year or two, the proportion of commercial loans has increased significantly. Because there is a shortage of funds from governmental sources, and the loan procedure is complicated and time-consuming, and relatively speaking, commercial loans are easily accessed, and fund utilization is less restrictive, it has become necessary to obtain more commercial loans. We must, however, be more careful about securing and utilizing these loans, and at the same time we should explore additional governmental sources and channels, and obtain as many loans as possible from governmental sources.

2. *The mix of fund markets and lenders.* In order to maintain a steady source of funds, we must explore and make use of more fund markets and find more suppliers of funds. Up till now, because of external factors, our foreign loan markets are limited to Japan and Singapore, and actual suppliers are also limited to a handful. This may prove unhealthy for our expanded use of foreign credit. Therefore, on the one hand, we should consider

issuing bonds in Switzerland, Hong Kong, and the Euro-dollar markets so as to avoid the hazards of issuing too many bonds in one market and damaging our credit standing. On the other hand, we must seek a broader range of fund suppliers so that we do not limit ourselves to a few lenders. Even within the same fund market, we want to borrow from different institutions such as banks, insurance companies, and various foundations. In sum, we must seek to diversify our source of loans and our supply of funds.

3. *The mix of different types of loans.* We must skillfully utilize several different methods to borrow funds in the international market. We should obtain commercial loans, but also issue bonds, including public and private issues. We should also adopt other popular methods of raising funds in the international financial market. Different types of loans have different characteristics and defects or advantages. We should make use of all of them with versatility to suit the needs of the units utilizing the funds, and take advantage of various conditions in the international market at different times.

4. *The structure of the terms of debt redemption.* The length of the loan period is one of the important indicators of how well the loans are structured. To properly arrange the debt redemption periods, we should start with the following:

a. *Tightly controlled short-term loans.* Short-term foreign loans are easy to obtain, but we also tend to overextend ourselves using them. They can also cause the loan structure to deteriorate. In order to meet the demand for funds, we must borrow a certain amount of short-term loans. However, in recent years, Fujian has increased its short-term loans significantly. In order to effectively control these loans, we first must control the total short-term loan amount. According to the World Bank, short-term loans for the financing of imports only lasts for 90 to 120 days. Therefore short-term loans generally should not exceed an amount equivalent to the country's 3-month import volume, and should preferably be below that amount under normal circumstances. Based on Fujian's foreign trade conditions, we must impose stricter limits, and use the 2-month figure instead. Secondly, we must restrict the use of short-term loans; they should be used for short-term cash flow situations and not for long-term investment purposes.

b. *The debt redemption period must coincide with the payback period of investments.* Today, Fujian is entering a period when foreign debts have to be repaid, but investments are not yet generating cash flow. This will create great difficulties in discharging the debts.

c. *We should spread out the debt redemption deadlines.* For the next few years, Fujian will remain in a peak period of foreign debt redemption which requires payment of principal and interest. We must adopt a series of measures to avoid the dangers posed by periods of peak payments.



5. *The interest rate structure and the currency mix.* Changes in the international economic situation often about bring changes in interest rates, and they directly affect the costs and benefits of the loans. Therefore in structuring loans, we must carefully consider the interest rate and the currency mix.

a. The interest rate structure. Interest rates on loans are either fixed or floating. From the point of simplicity in economic accounting, fixed-rate loans may be preferred. But from the point of the risk factors, if rates are comparable, an equal amount of fixed- and floating-rate loans is preferred. The general idea is that when the interest rate is stable, we should obtain fixed-rate loans; but when it tends to fluctuate, we should obtain floating-rate loans. To reduce the risks associated with rate changes, we first must make better forecasts of future rate changes. Second, we must consider interest rates along with the exchange rate. The interest rate may be lower for a certain currency, but it may be appreciating in value, and we must anticipate that at maturity, we have to pay back the loan in the equivalent amount of a currency whose value has appreciated. If it has appreciated by more than the interest-rate margin of other currencies, the borrower will lose. Conversely, another currency may command a higher interest rate, but its value is depreciating; if it depreciates by more than the interest-rate margin of other currencies, it will benefit the borrower. Therefore when considering the rate of interest for a specific currency, we must, at the same time, consider changes in exchange rates as a factor.

b. The currency mix. In terms of foreign currency mix, Fujian's foreign debt is structured such that 64.9 percent of the debts are in U.S. dollars, 18.9 percent are in yen, with other currencies make up only a small percentage. This mix lacks variety, and does not correspond to the main currencies needed for Fujian's import-export trade. As things stand, this currency mix will adversely affect our loan repayments in the future in the following ways: one, since 1985, exchange rates in the international financial market have been volatile; the value of the dollar has dropped substantially, but the yen remains strong. This will cause problems for us when we redeem our yen bonds. Two, in recent years, we have imported most of our goods from Japan, but most of our loans are in U.S. dollars. Three, due to the depreciation of the RMB, some projects financed by foreign loans are having foreign exchange balance problems which require adjustments, and this increases our outlay of matching funds in RMB.

It can be seen that the risks associated with exchange rates often are greater than those associated with interest rates. Whether we can accurately forecast the exchange rate will directly affect the cost of our loans. Because it is difficult to accurately predict future changes in exchange rates, and in order to avoid the hazards of exchange-rate fluctuations, we should adopt the following measures: one, coordinate the type of currencies we

borrow with the type of currencies we use in our import-export trade. Two, abandon the single currency format. Three, stipulate a clause which guarantees valuation in the loan contract. Four, adopt currency-swapping and other modern financial instruments.

### III. Strengthen and Perfect the Foreign Debt Management and Monitoring Systems

Under the existing system, Fujian's debt management is decentralized. There are as many as seven departments involved in foreign debt management. This scattered management system makes it difficult to get a handle on the foreign debt situation or manage and monitor foreign debts effectively. Furthermore, we do not have a healthy foreign debt adjustment and control mechanism. Borrowing, utilization, and repayment are not coordinated, and as a result we have failed to repay some interest and loans. Because of the present scattered and chaotic management, we need to establish an organization to coordinate foreign debt under the guiding principle of "adopting unified policies and plans and presenting a united front vis-a-vis outsiders," and "leaving management to the appropriate departments, while implementing division of labor and responsibility, and reinforcing coordination." On this basis, we can set up and perfect a foreign debt monitoring system to promptly monitor changes in foreign debt conditions, and offer appropriate responses.

In order to effectively manage and monitor foreign debt, we must be more vigilant about enacting foreign debt management policies. This mainly would involve the following measures. First, before the borrowed funds are put to use, the Bank of China should borrow them on a short-term basis, and pay interest, according to inter-bank lending and borrowing procedures in the international financial markets, to speed up the turnover of foreign credit funds. Second, we should allow the Huafu Co and the central bank to engage in foreign debt swapping and foreign exchange collateral loan operations. They should be given their share of the profit and bear the corresponding responsibilities. Third, we should enact laws to govern foreign debts; designate foreign debt management departments; specify foreign debt usage and method of repayment, and identity the rights and obligations of the borrower. By adopting these measures we can perfect the management and monitoring of foreign debts.

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## ECONOMIC ZONES

### Problems Point Out Need for Better Foreign Trade Management in the SEZs

40060050 Beijing GUOJI MAOYI WENTI  
[INTERNATIONAL TRADE JOURNAL] in Chinese  
No 4, 1987 pp 4-8

[Article by Li Shi [2621 6108]: "Preliminary Investigation of Foreign Trade Management in the SEZs"]

[Excerpt] The opening of the SEZs was a major experiment in China's implementation of its policy of opening to the outside, and attention has been focused on them both here and abroad. As reform of the economic management system proceeds, with the application of a series of special preferential measures, China's SEZs have developed rapidly. As the SEZs have taken off, they have played an extraordinarily important role in foreign trade. The SEZs themselves have scant resources and limited markets; if they do not take full advantage of Chinese and foreign resources, capital, and markets, it will be difficult to develop industry in them. Setting up SEZ industries aimed primarily at the international market will not only enrich the local economy and generate foreign exchange, it will also make it possible to absorb more foreign capital, introduce more advanced technology, equipment, and management methods, and better exploit the SEZs' role as "windows." Therefore, vigorous development of SEZ foreign trade, enthusiastic opening of international markets, and expansion of exports are not only matters requiring close attention for the SEZs' own development, they are also related to the important questions of whether China's strategic intention in establishing the SEZs can be realized, and whether the policy of opening to the outside can be implemented on a healthy, long-term basis.

Expanding exports is the key to developing foreign trade in the SEZs. Export trade constitutes the foundation of SEZ foreign trade. This article investigates several issues affecting the expansion of export trade in China's SEZs.

#### **Problems Deserving Attention in the Development of SEZ Foreign Export Trade**

In examining the positive role played by foreign trade in establishing and enriching the SEZs, we should also look at some persistent problems deserving attention in the development of SEZ foreign trade. These problems involve the following principal areas:

1. Still lacking the scale for export-oriented production and producing few or none of their own products, some SEZ companies with import-export rights turn inland to purchase popular export goods at inflated prices, which they then sell on foreign markets at competitive low prices, competing with normal trade by taking advantage of the preferential conditions granted them in exporting, retention of foreign exchange, etc. Now, many SEZ companies have established partner companies in the interior, following the SEZ goal of introducing foreign technology to the interior. Through these interior companies, the SEZ companies are actually taking the resources of the interior and using them as SEZ products. Taking advantage of the 100 percent retention of foreign exchange by the SEZs, the SEZ companies illegally intercept the foreign exchange that would normally be paid to the central government when export goods are sold by the local governments. At the same time, these companies do not deal in a clearly defined range of commodities. When they exhaust one local source of

commodities, they move to the commodities available from another locality. This renders macrocontrol over foreign trade more difficult.

2. The management contract system still being applied to SEZ exports basically means that the SEZs are not charged with exporting to generate foreign exchange for the state, though they do account for a very large portion of export quotas. Their fresh produce in particular interferes considerably with planned exports, and this has greatly dampened the enthusiasm of foreign trade departments in the inland provinces for developing their own areas, supporting production, and expanding exports.

3. Some SEZs do not conduct their exchange settlements for exports through banks but rather handle them themselves. According to foreign trade statistics from the Shenzhen Office of Foreign Economic Relations and Trade, 1985 exports from January through July totaled \$264.95 million; according to bank statistics, however, only \$178.9 in foreign exchange was taken in, leaving a discrepancy of \$86 million. The whereabouts of foreign exchange taken in after exporting is not known. After exporting commodities, some enterprises also avoid foreign exchange settlements, instead making direct deposits in spot foreign exchange accounts. According to statistics from the Shenzhen branch of the Bank of China, from January through August of 1985 a total of \$186.44 million in foreign exchange was taken in; only \$73 million of this was exchange settlements, and most of this was from enterprises under various departments of the central government located in Shenzhen. Spot foreign exchange accounts do offer flexibility, but they have serious drawbacks, and an increase has already been noted in the lending of accounts to others, transfers of foreign exchange based on enterprise contracts and bills, etc. In the Hainandao automobile affair, Shenzhen transferred out \$90 million, most of it coming from spot foreign exchange accounts.

These problems in developing SEZ foreign trade not only hinder the SEZ shift from an import-oriented to an export-oriented economy but also do not promote coordinated development of the SEZs with the interior. This makes it more difficult to ensure that the state's export plans are met and hinders the vigorous development of foreign trade on an integrated, unified basis. At the same time, these problems may damage normal trade and increase confusion in markets, clients, and prices, which would not promote stability and vigor in the Hong Kong and Macao market. Therefore, in conjunction with the positive measures adopted by the relevant SEZ departments, the state has also strengthened its macrocontrol over foreign trade, instituting a permit system for commodity imports and exports in 1985, and in 1986 it adopted overall quotas with permit control for Hong Kong and Macao. Experience over the last year or so has shown that increased macrocontrol promotes the opening to the outside, and the total flow of commodities from China to Hong Kong has been quite effectively

controlled. The impact of illegal imports and exports has to a certain extent been brought under control, marketing channels are becoming more and more stable, and the existing specializations in production are being maintained. The chaotic situation occurring in 1984 in the Hong Kong and Macao market has now been turned around. In 1986 Chinese exports to Hong Kong and Macao reached record-breaking levels, restoring China to first place in exports to those territories.

### **How to Strengthen Macrocontrol Over SEZ Export Trade**

After macrocontrol over foreign trade was strengthened throughout the country, SEZ foreign trade entered a new phase. Below I offer some still incomplete views from the viewpoint of macrocontrol on how to take full advantage of the potential and the advantages of the SEZs, while presupposing the state's uniform guidance and centralized control, to increase exports and generate more foreign exchange, to coordinate their development with the interior so as to invigorate China's export trade, and to promote the four modernizations.

#### **1. Guiding Philosophy Behind Foreign Trade Management of SEZs**

Foreign trade management over SEZs requires that the state strengthen its macrocontrol and guidance over economic activity in the SEZs; it should also consider their unique nature and flexibility and adopt practical and feasible management methods different from those in the interior in keeping with the SEZs' different conditions.

The state should strengthen its macrocontrol and guidance over SEZ foreign trade activity for the following reasons: the SEZs' foreign trade economy is an organic component of the entire country's foreign trade economy, and their foreign trade activity takes place under the macroeconomic guidance of the country's socialist economy rather than constituting an "independent kingdom;" second, their foreign trade activity is directed primarily at the Hong Kong and Macao market. Hong Kong and Macao constitute a special market in China's foreign trade. The spot exchange that China earns from Hong Kong and Macao each year accounts for one-fourth of her total foreign exchange income. Proper handling of Hong Kong and Macao trade is therefore an economic necessity and is extremely significant for continuing to be able to ensure economic vigor after Chinese sovereignty over Hong Kong is restored in 1997. At the same time, there are limits to the capacity of the Hong Kong and Macao market, and exports cannot be expanded ad infinitum; competition is also very fierce, with supply exceeding demand and internal competition leading to lower prices and causing the state to suffer losses. Given the particularities and capacity of the Hong Kong and Macao market, macrocontrol and comprehensive administration of Hong Kong and Macao export trade must be strengthened. Third, China's SEZs are

oriented towards cooperation with the interior. Many of the economic zones established by other countries and regions are intended primarily to promote export trade, earn foreign exchange, and increase employment. Hence most of them import raw materials and semifinished products for processing and assembly for export and do not have very close economic and technical relationships with other areas of the country in question. China's SEZs, on the other hand, have a vast hinterland to deal with and receive broad support from the interior. Development of SEZ foreign trade in particular must rely on the raw materials, semifinished products, and traditional famous brands of goods from the interior to make up for shortages of their own raw materials, capital, and technology. At the same time, the SEZs are also responsible for introducing technology, speeding up technological transfers, and promoting socialist modernization of the entire country. Proper handling of the relationship between SEZ foreign trade and the cities and provinces of the interior, expanding cooperation, exchange, and development between the SEZs and the interior, and reversing the present confusion in organizing sources of export goods also require that the state's macroeconomic guidance and coordination be strengthened in order to mobilize the enthusiasm of the SEZs and of the provinces and cities of the interior and promote joint development.

China's foreign trade management should facilitate maintaining the state's overall and long-term interests and encouraging and promoting development of export-oriented economies for the SEZs so that they can serve as windows. This management must therefore begin with the actual circumstances of the SEZs, and must be flexible.

The reasons foreign trade management in the SEZs should be flexible are, first, given the goal of the SEZs, which is to develop an export-oriented economy, if they make no greater contribution in the area of exporting to generate foreign exchange, then they lose their significance as special economic zones. Second, we should note that SEZs not only should generate more foreign exchange but are able to do so. The SEZs have all sorts of advantages for opening up international markets. Below we shall use only the export of fresh produce as an example and analyze the issue of management having to be flexible as well as good.

The SEZs, particularly Shenzhen and Zhuhai, are close to Hong Kong and Macao and are well suited to developing exports of such fresh produce as vegetables, pond-raised fish, fruit, and poultry; their advantages include short transport distance, high degree of freshness, and low exchange costs. At the same time, the SEZs have taken advantage of special preferential policies to bring in advanced technology and vigorously developed production bases, so that their products have progressively become higher in quality, more refined, fresher, and more attractive; they have also exploited their proximity

to markets, up-to-date information, rapid market adaptability, and strong competitiveness. For these reasons, exports of fresh produce have developed quickly. At the same time, however, these advantages have been stymied by inflexible management. For example, fewer than 20 percent of the live hogs China exports to Hong Kong are lean-meat hogs. In 1985, Shenzhen exported 65,000 lean-meat hogs to Hong Kong, selling them at \$100 each, while the fatty hogs exported from other areas brought only \$50 or \$60. In 1986 Shenzhen may export 80,000 hogs, but Guangdong's quota is only 45,000 hogs. As another example, the Longgang chickens produced in Shenzhen do quite well on the Hong Kong market, with 1985 exports of 9.5 million birds and plans for 10 million in 1986, but Guangdong's quota is only 4.5 million. On the one hand, the large quantities of products awaiting speedy export from the Shenzhen SEZ would suffer without these quotas; on the other, the fresh agricultural and sideline products sent to Hong Kong from the interior come from more than 20 provinces and municipalities throughout the country, and their foreign trade departments and production and supply departments have been charged with exporting to generate foreign exchange, having established long-term cooperative relationships and creating export channels over the years. Because of the poor transport conditions and undeveloped technology for maintaining freshness, the long transport distance leads to lesser freshness, higher losses, reduced quality, and higher cost. The live-arrival rate for hogs shipped through Shenzhen to Hong Kong is less than 90 percent; for cattle it is less than 80 percent, and for fish, less than 60 percent. As another example, vegetables passing through Guangzhou for export not only involve high transport costs (railway wagon utilization rate of only about 70 percent) and heavy losses (5 percent for leafy vegetables, 2 percent for legumes), but they also often fail to reach the market on time because of the long distance. But quotas must still be assigned to these areas, because Shenzhen retains all the foreign exchange it earns, while the interior provinces and regions with export assignments naturally are responsible for earning exchange for the state.

As related above, the fresh commodities sent to the Hong Kong and Macao market must be managed, or supply will exceed demand, which would not only cause prices to fall but would easily cause deterioration, waste, and unbearable losses. If supply falls short of demand, however, it may cause a slowdown or cutoff in supply, with foreign goods coming in to take advantage of the gap and taking over the market; once the market is lost, getting it back will be a real problem. Management can offer a united front against the outside, provide a stable source of goods, and make it possible sell more at better prices. The question is what sort of management. At present, the Hong Kong and Macao market is very tightly linked to the mainland, and the reality is that all sorts of trade channels exist side by side. Given the complexity of

exporting to Hong Kong and Macao, we must exert proper macrocontrol and guidance, while providing flexible management that accords with the actual circumstances of the SEZs.

## 2. Proposals for SEZ Foreign Trade Management

I am presenting below several proposals regarding how to encourage and support the SEZs in accelerating the pace and degree of their development of export-oriented economies, while at the same time better coordinating the relationship between the development of foreign trade in the SEZs and in the rest of the country.

A. Export our best products. Exporting our best products promotes greater foreign exchange income for the state. This is because expanding markets, getting higher prices, and increasing foreign exchange income are dependent mainly on improving the quality of our commodities. In exporting fresh agricultural, sideline, and native produce, the limited capacity of the Hong Kong and Macao market requires that the quantities supplied to Hong Kong be subject to reasonable controls. Management by export quotas, however, must not be aimed exclusively at the equal sharing of profits without considering geographic proximity; giving preference to remote regions may cause tremendous waste and weaken the competitiveness of Chinese goods in the Hong Kong and Macao market. Starting from this principle, the quotas for high-quality agricultural, sideline, and native products from areas near Hong Kong should be suitably increased. Under the principle of strengthening centralized management over foreign trade and presenting a united front to the outside, allowing operations by more entrepreneurs, developing competition where appropriate, and exporting our best products would not only help to overcome the problem of declining product quality due to excessively complex management and improve the freshness and raise the exchange rate of fresh produce, it would also be helpful in improving management and adapting products to their market. In the area of exporting industrial goods, the SEZs should enthusiastically set about getting raw materials, semifinished products, and traditional name-brand products from the interior for export after finishing in the SEZs. SEZ foreign trade management should create the conditions for expanding exports of the products described above and should provide support in the areas of permits and quotas.

B. Retention of foreign exchange by the SEZs should be appropriately reduced, and they should take on some of the planned exporting and exchange generation for the state. The current exchange-retention system has certainly played a role in mobilizing the enthusiasm of local governments, departments, and enterprises for generating foreign exchange, but it has caused many problems, particularly in terms of uneven retention levels and burdens among local governments and departments, causing competition from one area to another in finding sources of export goods, markets, and clients, so that they buy at inflated prices in China only to sell at low

prices abroad. The high degree of exchange retention by SEZs has meant that large quantities of goods from the interior have passed through the SEZs for export, and this joining of the SEZs and the interior is due to their common economic interests. In terms of the interior, supply departments turn over goods to the provincial foreign trade department for export; the foreign trade departments buy these goods at low prices, leaving the supply departments with little profit, and little foreign exchange retained after the goods are exported (according to regulations, the enterprise gets only 12.5 percent, and this is only a foreign exchange target; even though an enterprise gets foreign exchange, the amount is so small, and the red tape involved in using it so complex, it is impossible or very inconvenient to adjust the amount, so there is no way to apply or circulate that foreign exchange). If goods are turned over to an SEZ for export, the SEZ, as seller, can sell at a high price according to its high foreign exchange rate, and as agent it shares the 100 percent retention of foreign exchange. SEZ enterprises, on the other hand, may use their retained foreign exchange to import high-profit commodities and earn themselves a fine profit. These profits are in turn used to purchase products at high prices from the interior for export; they force down their prices to be competitive, thus creating confusion in market prices and among clients and greatly reducing the foreign exchange earned by the state. Recently we have also seen Hong Kong businessmen using Shenzhen to sell American dollars at a high price in exchange for renminbi; then, in collaboration with paper companies in the interior, they illegally buy up Chinese goods on the condition that they be paid for in renminbi rather than dollars. Hence, if we are to solve foreign trade problems in the SEZs, we should do away with the exchange retention approach that leaves such wide gaps from one administrative region to another, evening out the retention rates, with the foreign exchange required by the SEZs being allocated to them solely by the state's financial departments. If the SEZs take on some of the task of planned exporting to generate foreign exchange, export quotas can be suitably increased, which would help SEZ enterprises shift enthusiastically to an export orientation; it would also help settle the relationship between the SEZs and the interior and would increase the state's foreign exchange income.

C. An authoritative body having centralized control over SEZ foreign trade should be established to exercise uniform management over SEZ imports and exports, under the guidance of MOFERT and the responsible trade departments of the provinces involved. Import-export management should also be combined with foreign exchange and customs management to create a complete management system. As for export management in SEZs, I believe that the SEZs should be allowed to see to the export of all SEZ-produced products (including commodities under central administration and controlled by permit) in keeping with the state's production plans; as for retention of foreign exchange, the SEZs should be given appropriate consideration in order to encourage them to develop export-oriented economies.

Export commodities sold to Hong Kong and Macao and controlled by quotas and permits should be the subject of a plan drafted annually by the SEZ government and reported to the responsible departments for approval. The SEZ government should proceed to handle its own exports within the scope of its approved plans. All commodities sold overseas (including industrial and agricultural products), with the exception of those controlled by state quotas or permits, would be approved for export by the SEZ government itself, with these exports reported to the responsible provincial and national foreign trade departments for recording. When exchange costs and export prices meet state regulations, the SEZs would be allowed to seek sources of goods for export from the interior; in the case of commodities sold overseas that have low exchange costs and high export prices, in particular, the SEZs would be allowed to export more to generate more foreign exchange, so as to accelerate development of an export-oriented economy.

At the same time as SEZ foreign trade management is strengthened, the SEZs themselves should also develop more export-oriented enterprises producing refined and sophisticated finished products so as to develop their own, unique, fast-selling products to compete with foreign products on the international market. This approach, combining centralized state management of foreign trade with the actual circumstances of the SEZs, would coordinate the development of foreign trade between the SEZs and the country as a whole, pushing the SEZs' export-oriented economies to a higher stage of development.

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#### **Guizhou Export Income**

*HK010618 Guiyang Guizhou Provincial Service in Mandarin 2300 GMT 21 Dec 87*

[Summary] By the end of November, the province had earned some \$10.42 million from exporting mechanical and electronic products, an increase of nearly 100 percent over last year.

#### **Shanghai's Labor System Discussed**

*40060056 Shanghai JIEFANG RIBAO in Chinese 8 Oct 87 p 1*

[Article by Jiang Mengdan [5592 1125 0030] and Hu Chunyu [5170 2504 7183]: "Shanghai Has Firmly Reorganized Its Labor System, Found Jobs for 1.88 Million People in the Last 8 Years, and Now Has More Than 220,000 Contract Workers"]

[Text] Shanghai's labor system has experienced three major changes in the 8 years since the 3d Plenum of the 11th CPC Congress. It has made new advances in areas, such as recruiting, employing, and hiring of workers, vigorously struck down the old rigid system of guaranteed employment, and opened up broad prospects for

making better use of its workers' abilities and initiative. Statistics show that Shanghai Municipality has found jobs for 1,880,500 people in the past 8 years.

#### **From "One Opportunity" to "Many Opportunities"**

Employment of workers is a major issue for the national economy and affects the vital interests of the masses. But the highly centralized planned economy that was in effect for many years created a situation in which the entire urban labor force was dependent on guaranteed employment by the state. Workers' employment opportunities had narrowed basically to the point where the only route left open to them was to be squeezed into state-owned enterprises. On one hand, this made many unemployed people wait year after year for the state to assign them jobs while, on the other, quite a lot of production and service opportunities went begging. After the "gang of four" was smashed, this contradiction became particularly obvious for a time when far too many educated urban youth, who had been sent down to work in the countryside and were allowed to return to the cities, and newly matured workers entered the labor market. In 1980, guided by the spirit of the National Labor Employment Conference, Shanghai began to practice an integrated three-in-one employment policy of introduction to employment by labor departments, voluntary organization of employment, and independent planning of occupations. In addition to recruiting workers for state-owned enterprises, it actively encouraged unemployed youth to find jobs in collective enterprises, promoted development of township and individual economies, and urged unemployed youth to plan their own occupations.

The three-in-one employment policy ended the situation of workers being able to find jobs only in state-owned enterprises and broadened their employment opportunities. From 1979 to the end of 1986, 529,000 persons throughout Shanghai found jobs in collective units, the ranks of workers in the individual economy expanded quickly, and 37,700 previously unemployed urban youth alone are now self-employed workers. In these few short years, not only were jobs found for the leftover high school graduates from the preceding years, but the issue of placing the educated youth who were allowed by policy to return to the city was also settled. Since then, employment of workers has gotten back onto the right track.

#### **From "Family Orientation" to "Mutual Choice"**

China's state-owned enterprises have long recruited and hired workers through centralized administrative methods. Neither the enterprises nor the individual workers had any choice in the matter. By the time of the Cultural Revolution, this system of guaranteed employment had reached the point where the factor that determined whether people would be employed by industrial enterprises or sent down to work in the countryside was

actually their so-called "family orientation." Consequently, many people could not choose their own occupations, enterprises were saddled with heavy burdens, and some workers were not suited to their jobs, could not be used, and were even assigned to care for convalescents in their enterprises.

Shanghai's system of recruiting workers began to undergo a series of reforms in 1979. By 1984, it had been changed to the point where enterprises could directly assess the proficiency of their workers. Within the scope of labor plans, enterprises were given the right to openly recruit workers in their neighborhoods as needed, set recruitment standards based on production characteristics, dismiss those who were found to be unqualified after a period of probation, and refuse to hire those that any department or individual tried to force on them in violation of state regulations. Since then, enterprises have had the power to recruit and hire workers on their own initiative.

A new situation has appeared in Shanghai's worker recruitment since the end of 1986 that has further expanded the scope of mutual choice by workers and recruiting units. Labor departments in all districts and counties have been using the market mechanism and various other ways to allow enterprises and workers to meet directly, talk freely, and make their own choices. This has been generally well-received by both recruiting units and workers. Incomplete statistics show that more than 6,000 Shanghai workers have found jobs that they are pleased with in this way.

#### **From "Once Assigned, Stuck for Life" to "Job Mobility"**

Since the founding of the PRC, China has always used a fixed labor system wherein once workers were assigned jobs, they were stuck in them for life and had no job mobility. In 1980, some enterprises in six Shanghai bureaus, such as the Textile Industry Bureau, the Handicraft Industry Bureau, and the Light Industry Bureau, began to try out a labor contract system for recruiting and hiring new workers. Based on this, the Shanghai Municipal Government issued "Temporary Provisions for Carrying out a Labor Contract System in Shanghai's State-owned Enterprises" in 1984. It decided that due to long-standing production or job needs in Shanghai's state-owned enterprises, a labor contract system would be carried out for recruiting and hiring all new workers. By July 1987, there were more than 220,000 contract workers throughout Shanghai. Defining the labor relationship between enterprises and workers with labor contracts not only ensures enterprises the power to choose workers for jobs and workers the right to choose their own occupations, but also creates the conditions for rational labor mobility. The labor contract system that has been carried out for the past few years is now being understood and accepted by increasing numbers of people and is appreciated and supported by all sides.

Moreover, a complete set of reforms has also emerged along with the changed system of hiring workers. 1) an old-age social insurance system has been set up, wherein fixed old-age insurance premiums are paid by enterprises and contract workers, and those contract workers who meet retirement conditions and reach retirement age are paid monthly retirement pensions by the social insurance agency. 2) An unemployment insurance system has been set up for staff members and workers, wherein all unemployed staff members and workers who meet the conditions are paid unemployment relief funds by local labor service companies based on their length of service and how long they are unemployed. By the end of August 1987, 14,058 persons throughout Shanghai were receiving unemployment relief funds. 3) A commission has been set up to arbitrate labor disputes, wherein disputants from either side of labor contracts or dismissed staff members and workers who disagree with the way their enterprises have treated them can appeal to the labor dispute arbitration commission in the district or county where their enterprise is located. 4) An agency has been set up to regulate the labor force.

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## PRC MEDIA ON FOREIGN ECONOMIES

### Country Urged To Learn From East Europe's Experience in Wage Reform

40050122 Shanghai SHEHUI KEXUE [SOCIAL  
SCIENCES] in Chinese No 11, 15 Nov 87 p 46-49

[Article by Wang Jiafeng [3769 0857 1496]: "Successes and Failures in Wage Reform in East Europe"]

[Excerpts] The wage system is an important part of the economic system. Wage reform plays a pivotal role in determining the progress of economic structural reform overall because it directly influences the mobilization of the initiative of the master of productive forces—the worker. East European nations have had both successes and failures in wage reform. To analyze and study them closely will clearly teach us something as we try to make wage reform in China a success. This article takes a look at the objectives of wage reform, the macroeconomic control of wage functional mechanisms, the timing of reform, and the sequence of reform.

Wage reform involves a host of factors, is highly sensitive, and constitutes a key policy issue. Therefore, preparing for reform in every detailed way, selecting an opportune moment to act, and achieving tangible progress in reform has an impact on the success of wage and other coordinated reforms that cannot be underestimated. In this aspect, we can learn from the East European experience.

First, wage reform in most East European nations usually took place after economic structural reform as a whole had gone on for sometime. The reason is that since

wage and other mechanisms such as prices and taxation interact with and restrain one another, it is impossible to put wage reform ahead of others. Thus most East European nations did not touch their original wage management system in the initial period of economic reform. Yugoslavia, for instance, initiated a worker self-management system as early as 1950 but withheld autonomy in wage matters. By 1954, enterprise leaders had been authorized to devise their own wage distribution methods within their enterprises, but the overall wage levels were still being set based on the average wage standards in the social plan, a restriction not eased until 1957. This wage regulation system proved a hindrance to the development of worker self-management, so in 1961 all wage decision-making power was turned over to enterprises. On and off, the process took a long 11 years. Hungary, too, left its traditional wage regulation system alone when it first embarked on reform in order to avoid massive layoffs and maintain a stable social environment.

Second, wage reform must be preceded by full preparations and implemented across the board at a time when the economy is doing relatively well. In delegating wage decision-making power to enterprises, Yugoslavia issued for their guidance the "Regulations Concerning Enterprise and Individual Income Distribution" explaining the components of personal income and their meanings. Hungary, Romania, Poland, and Bulgaria consolidated and simplified their existing elaborate wage classifications and grades. To determine which enterprise should apply which wage regulation system, Hungary even had the assets of each enterprise sorted out and assessed. Moreover, most East European nations took care to time their wage reform properly, usually acting when the economy was expanding steadily and inflation was low. In contrast, Poland launched wage reform in 1973 when the national economy was under strains and all proportionate relations in the economy were seriously out of balance. After the government lifted wage control, wages rose rapidly without, however, corresponding gains in consumer goods production. The upshot was that demand outpaced supply, which in turn led to high inflation. In 1976, wage reform came to a premature end less than 3 years after it began.

Third, wage reform should be continuously furthered in stages step by step to perfect the new wage system. We know that the conditions for reform must be created gradually and that reform measures have to be fine-tuned constantly. In addition, new conditions and problems will appear endlessly. Thus to try to resolve overnight all wage problems accumulated over the years is bound to make a mess of things. Take wage reform in Poland in 1973, for instance. The sudden shift from a highly centralized management model to the "parameter regulating system" which included a strong dosage of market regulation led to a loss of control over wage funds, resulting in economic turbulence and social unrest. In contrast, Hungary proceeded more cautiously, constantly adjusting its reform measures and amplifying



the methods of wage regulation in light of the new circumstances that appeared in the course of wage reform. Consequently, it had more smooth sailing and was able to steer economic structural reform overall in a more viable direction.

In China, the wage reform program of 1985 was among the early batch of economic reform plans to be unveiled. Wage reform was particularly far-reaching in organs and institutional units where composite wages made up of base wages, job wages, and seniority allowances replaced the monolithic wage system introduced in 1956. However, conditions for the implementation of the composite wage system were not totally in place and funds required for reform were in short supply. Thus the actual results of wage reform have not been as satisfactory as anticipated. Meanwhile, enterprises have been carrying out a pilot project linking the overall wage level to and allowing it to float with the amount of profits turned over to the state, this at a time when the price system has not been rationalized and the linkage base and floating ratio have not been properly worked out. The result is that efficient workers and units often end up being penalized. These circumstances provide us with much food for thought.

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## AGRICULTURE

### Speech by Du Runsheng on Hydraulic Engineering

40060068 Beijing ZHONGGUO SHUILI [CHINA WATER CONSERVANCY] in Chinese  
No 11, 15 Nov 87 pp 4-6

[“Abridged version” of speech by Du Runsheng [2629 3387 3932] to the Hydraulic Engineering Symposium; date, place not given]

[Text] This symposium is an annual affair. Over the past several years, hydraulic engineering work has continually improved. I approve of Minister Qian's decision to hold this meeting. And there are all sorts of reasons why we must strengthen this work.

I

To fundamentally resolve the problems in the countryside, in agriculture and of peasants, we must rely on two measures—deepening reform and increasing inputs. We must carry out technological transformation, intensify agricultural operations, gradually modernize, and transform traditional agriculture. During our effort to stress reform over the past few years, we slackened our work in hydraulic engineering—investment in this area has declined, facilities have fallen into disrepair, needed support projects have not been undertaken, and maintenance has been neglected; much less can we claim to have made any progress in this work. Nevertheless, the matter must be examined from all sides. Although

hydraulic engineering was insufficiently stressed during agricultural reform, the reform did create new material and spiritual conditions for hydraulic engineering. The material condition is that peasants' enthusiasm for this work has increased. To raise output, they naturally want to see problems in hydraulic engineering resolved. 800 million peasants have made this their demand, and it is this development that has given new impetus to further improvement in hydraulic engineering. No matter what the issue is, it will retain momentum so long as the masses demand it. Reform has increased peasants' income and savings, so peasants now hold surplus capital. In many regions, peasants on a per capita average have accumulated savings of approximately 90 yuan and have held 90 yuan in cash on hand over the past several years. This is unprecedented. In the past, hydraulic engineering was totally dependent on state investment, but now we can have the state and the people cooperate in funding projects, with the government providing some of the funding and the peasants the rest. We can also continue labor investment in this work. In addition, reform has engendered a good thing that is not readily apparent, which is that new changes have occurred in people's thinking and that these changes have motivated us to improve hydraulic engineering. Premier Zhao has noted that hydraulic engineering must be undertaken but that the means by which it is done must be changed; that is, we must stress economic returns in this work. Since last year, this notion has been further clarified and implemented. In the past several years, we have begun to stress maintenance of and support works for hydraulic engineering projects and to emphasize practical results, and these efforts are an expression of the spirit of reform. In the past, we did not build branch channels when we dug main channels, so the latter silted up and the former were never dug. We also used to build irrigation projects without including drainage works, so agricultural land suffered secondary saline-alkalinization. Boy, have we suffered from these oversights! But over the past few years, the Ministry of Water Resources and Electric Power has attached proper importance to maintenance and to support projects, and this is a correct move. For example, people would have had a very hard time accepting the collection of water fees had it not been for reform. China suffers from a severe shortage of water resources, and water would surely be wasted if we allowed people to use it for free. Other such things as the development of diversified agricultural operations and the establishment of the responsibility system have also resulted from reform. The fact that hydraulic engineering has begun to emphasize economic returns marks a major shift which will assume greater and greater importance as time goes by. Reform must be deepened throughout China's countryside, and we should also deepen reform in hydraulic engineering. The symposium also produced the Report on Developing Rural Hydraulic Engineering so as To Strengthen Agricultural Rear Services, which document addressed the aforementioned issues. This is very good.

II (Omitted)



### III

As rural reform deepens, we must steadily increase agricultural inputs and carry out technological transformation of agriculture. The experience of various countries in the world proves a truth, which is that the main problem in a nation's agriculture is not that there is heavy population pressure on land or that natural conditions are unfavorable, but rather that that nation's farm productivity is low, its modes of production are backward and it lacks economic strength. Some countries, such as the Netherlands, England and Japan, which have much the same heavy population pressure on land as China does still have managed to do well in agriculture. England, for example, has a only few inches more of land per capita than we do. For a long time, she used to import much of her grain and thus suffered problems in her grain supply during World War II. But beginning with the 1960s, she made great efforts to become self-sufficient, and she has basically achieved this goal over the past 20 years. England's natural conditions are even worse than ours, but the keys to her recent success in agriculture lie in carrying out technological transformation of her agriculture and in improving her agricultural mode of production. So China must renovate her mode of production and her technology and modernize her traditional agriculture. To transform our extensive, unproductive farming system into an intensive system, we must increase inputs and provide modernized material and technological bases for our agriculture, including such areas as energy, electricity, communications, transport, storage, chemical fertilizers, pesticides, seeds and other S & T. The most important of these bases for China is hydraulic engineering, which may not be so crucial for some countries enjoying favorable climates. The most fundamental issues in China's agricultural development are hydraulic engineering, chemical fertilizer and energy. In the north, most precipitation is concentrated in the months of July, August and September; the other nine months are relatively dry. Thus since ancient times, Chinese governments have had to undertake hydraulic engineering, and China's state system, internal unification and other historical factors have all been related to hydraulic engineering.

Land is a limited resource. But increasing inputs in agriculture is the equivalent of increasing the amount of land at our disposal, and undertaking more hydraulic engineering, using more chemical fertilizer and applying more S & T to agriculture will in effect serve to replace land. That is to say, we can resolve the problem of land scarcity by using various means to increase productivity. For example, if one mu of land yields 100, 200 or 300 jin [of produce] and another produces 900 jin, then the latter case is equivalent to increasing the amount of land involved in the former case by two to eight fold. At one point, we had resolved the problem of labor inputs, but during the people's commune period everyone ate out of the same big pot, labor was not applied practically and much labor proved to be totally unproductive. But now the peasants run things themselves, and all of the labor

they apply is productive. In addition, although labor inputs are absolutely necessary, there must also be inputs of other energy [misprint for "resources"?], for with water and sunlight land productivity can be increased greatly.

Last year, we advocated rallying our forces, restoring enthusiasm and properly undertaking hydraulic engineering, and these efforts produced pretty good results. Two billion work days were invested in hydraulic engineering, which is quite an accomplishment and shows that the peasants are responsive to our policies. Nevertheless, we will not be able to improve this work if we rely solely on market readjustment; someone must come forward to lead the community. In the past, we relied on the government to do this, and we must still do so. We fervently hope that the various levels of government will do a number of practical things for the peasants next year. First, government must do a better job of supplying the means of production, above all chemical fertilizer. There was a shortage of this good this year, so everybody needed and scrambled for more, which left the peasants very disgruntled. Second, government must undertake hydraulic engineering. Existing facilities must be properly maintained and given needed support facilities. New projects must be organized. And third, the government must do a better job of supplying improved variety seeds. Thus, first comes chemical fertilizer, then comes hydraulic engineering and then comes seeds. We must take care of these things first.

As for what we should undertake in the way of hydraulic engineering, the symposium's Report on Developing Rural Hydraulic Engineering so as To Strengthen Agricultural Rear Services addressed this matter clearly. I believe our task will be centered around the goal of achieving [an annual] per capita grain supply of 800 jin and the campaign to concentrate our efforts to transform medium- and low-output land. This latter desideratum is related to hydraulic engineering, and so is the transformation of saline-alkali land, land susceptible to water logging and cold and immersed land. For high-yield land, we must increase returns on irrigation and, more importantly, effect more large-scale agricultural operations. The main problem in such places as suburban areas, southern Jiangsu and the Pearl River delta is to mechanize agricultural labor so as to improve labor productivity. In these places, yields on cultivated land are already quite high and marginal returns [on labor?] have declined, so we must withdraw surplus labor from the agriculture of these areas, use less labor to cultivate the land, increase returns from it [vague pronoun; as published] and maintain high levels of output in the process. Medium-output land accounts for much of China's agricultural land. If the land in northern Jiangsu, northern Anhui, Hebei, Shandong, Henan, the three provinces of the Northeast and land near the two great bends in the Huang He are properly transformed, such areas will become new grain producers, new high-output regions and new commodity grain bases. We must develop a bit of irrigation in some of these cases and

undertake support projects in others. For example, if the problem of drainage can be resolved in the area around the great bend in the Yellow River in Inner Mongolia, it should be easy to increase grain output in that area by several hundreds of millions of jin. In other cases, we must control saline-alkalinization, and in others we must check cold immersion of land. In arid regions, we can develop water sources and create small oases. Where there is no water, we will have to develop dry cropping. Dry cropping must be included in the work of hydraulic engineering and in valley control programs. The key to dealing with dry land is to exploit soil water retention capability as much as possible so as to use the rain water that falls largely during the three months of fall when it is really needed, in the the spring. To accomplish this, we must practice deep plowing, preserve soil moisture, increase inputs of organic fertilizer, deepen the active soil layer, level land and terrace hill sides. This year Hebei has pioneered a new method of terracing. That province uses ammonia nitrate to blast away large sections of hill sides, levels the area thereby created, plants fruit trees around the edges of these new fields and grows grain in the fields. Therefore, hydraulic engineering departments not only must transform dry lands into irrigated fields, they must also resolve the problems of water retention and soil moisture preservation associated with dry cropping.

#### IV

We must advance the reform of hydraulic engineering. Premier Zhao stated, "We certainly do not oppose hydraulic engineering, what we are afraid of is failing to produce results in this work." To produce results, we must conduct reform.

The first thing we must do in our effort to reform hydraulic engineering is to carefully formulate different programs for different regions. This is a matter of macroscopic policy, which if improperly formulated will cause a waste of funds. For example, in areas such as the Northwest, we should carry out dry cropping, build reservoirs and carry water to irrigate fields, but we should undertake these efforts only if they will clearly produce results. And we must also use the snow melt-off from the Tian Shan and the Qilian Shan, but we must ask ourselves how we are to manage this work on a large scale. Natural conditions differ between such regions as the loess plateau; northern China; the Huang, Huai and Hai He valleys; and the Southwest. So these regions should not mechanically copy land control measures employed in other places.

The second thing we must do in our reform effort is to restructure the hydraulic engineering administrative system, refrain from eating out of the same big pot and demarcate the roles of the government and the people. We should start experimenting with programs to organize the people, with government assistance, to undertake hydraulic engineering themselves, form their own hydraulic engineering organizations, raise their own

funds, manage the work themselves, keep the benefits for themselves and maintain facilities themselves. In the future, the people should be allowed to request loans and subsidies for projects they have drawn up. Most of the work we leave to the people should be small projects and control of small valleys. The people should be allowed to organize and autonomously manage water control projects involving a single region or covering more than one region. Government projects should be administered like enterprises, with diversified operations and with responsibility systems. Enterprise employees and cadres should have their own wage and labor systems. We need to reform the labor system and establish new labor management procedures not only in hydraulic engineering but also in forestry, the coal industry, mining and construction.

The third reform we must undertake is to institutionalize the system of funding hydraulic engineering, establishing special funds for specific projects and making investment on a project-by-project basis. We must allow entities at various levels to invest in hydraulic engineering, and we must diversify investment. For example, there should be government investment, investment by the people with government assistance, joint efforts to raise funds, community investment, joint investment by a number of households or investment by individuals. In addition, government investment should be improved. The government should not distribute funds equally among all units. There are 2,000-some counties in the nation, so what would happen if government investment were distributed to each of these units equally? It is hard to say, but the result would probably be that localities would be allowed to increase their bureaucracies to handle the funds, then run into trouble paying the salaries of their bureaucrats and end up having to use the investment funds to cover those salaries. On the whole, the direction we must take is to institutionalize funding, recycling some moneys, using some to subsidize a portion of local projects and using some to grant loans.

#### V

In sum, hydraulic engineering departments must come up with specific programs and means by which to implement the tasks of reform Comrade Zhao Ziyang has assigned us. We must figure out how to reform and how to begin getting returns from our work. Besides emphasizing projects, we must also put much effort into studying the proper way to implement reform. We hope local comrades will do the following. First, they must rally their forces, continue to advance and get started on their work for this winter and next spring as soon as possible. Second, they must strive to restore within the next two years investment to the level of 1980 and prevent hydraulic engineering funds from being diverted for other uses. We ask the provinces to pay particular attention to this. Third, local cadres must be innovative, create new administrative procedures and organizations, come up with means by which to raise and use funds and undertake some labor investment. For the latter, the

peasants should raise the needed funds themselves, but the labor and the funding must be handled correctly, policy in this area must be very proper and there must be no compulsion and commandism here. In this work, we must mesh short and long term interests and benefits, square the interests of all quarters and the benefits from all areas, determine whose is to benefit and who is not to benefit and clarify the interests and benefits of today and tomorrow. In other words, we must not simply approve labor investment and then start assigning labor tasks to lower levels. We must establish systems by which to regularize this work and stick to those systems. For example, I observed one locality which was recruiting people to undertake a year of labor on a project, which labor the locality promised to remunerate in installments over 5 years. As a result of this promise, not only those people who were going to benefit from the project were willing to participate in the labor, but even those who were not going to benefit showed up. The people proved very responsive to this approach. Thus when setting policy on labor investment, we must take into account the complex relationships of interests and benefits involved. If we become divorced from those relationships, we will have no policy at all. During the "Great Leap Forward," we did not study those relationships and instead practiced egalitarianism. But now, through reform, we have a new way of thinking about this issue and can thus do a better job of handling labor investment and capital accumulation. Our work continues to advance and improve and is getting more and more meticulous. Not only can we get things done right, we can also train new personnel in the process. So besides providing leadership and technical guidance, hydraulic engineering departments must also provide policy guidance.

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### **Model for Reform of Grain Circulation System Proposed**

40060097 Beijing NONGYE JINGJI WENTI  
[PROBLEMS OF AGRICULTURAL ECONOMY] in  
Chinese No 11, Nov 87 pp 38-40

[Article by Wu Shuo [0702 4311], of the Commercial and Economic Institute of the Ministry of Commerce: "The Ultimate Model for the Reform of China's Grain Circulation System"]

[Text] China's regular grain consumption runs approximately 400-plus metric tons a year, of which amount her demand for commodity grain runs 130 million metric tons. At normal growth rates, taken in conjunction with the recommended food intake program designed by the Health Institute of the Chinese Academy of Medical Sciences, China by the end of this century will consume approximately 500 to 530 million metric tons of grain each year, an average of 400-425 kg per capita, of which total commodity grain will account for about 250 million metric tons. However, with China's huge population, if everyone were to consume a little more or a little less

grain, the total resulting from such increases or decreases would add up to a big figure. Thus from this perspective, one can say that there is a certain amount of elasticity in China's demand for grain. Given the scale of production, output and marketed volume of grain in our country, it appears that grain production and consumption and supply and demand for commodity grain will remain basically in balance during normal harvest years the rest of this century; in years of good harvests, we should run a small surplus, but a smaller harvest the next year might present us with a small shortage. Naturally, however, structural imbalances will continue to persist among regions and crop types. This is the basic situation in China's grain supply.

Given this situation, we should be attentive to the following points in drawing up a model for China's future grain circulation system. (1) In a commodity economy, we must rely upon the marketplace when we try to regulate commodity grain production undertaken by 100-plus million rural households and attempt to bring the economic returns derived from increased inputs, expansion of productive operations and development of commodity grain production undertaken by rural households into line with the social benefits required by the state with respect to commodity grain. (2) Under socialism and given the need, due to the fact that our grain supply is not plentiful, to maintain a general balance between production and consumption and between supply and demand, it is even more essential that we provide good planned guidance and macroscopic control so as to prevent the blindness and profiteering that the market mechanism inevitably will engender and that we mesh indirect control and macroscopic regulation of grain growers and commodity grain enterprises with the operational autonomy of these growers and enterprises.

### **I. The Basic Principles of the Reform of the Grain Circulation System**

1. The model we should look for in our effort to reform China's economic administration is to create a planned commodity economy rooted in the system of public ownership. Thus the model we should adopt for the grain circulation system should be adapted to and form a component of the above model.

2. The model for grain grain circulation must facilitate development of the socialist state-owned economy and ensure that state grain trade is consolidated and developed so that it can play the leading role in grain trade. Units under other systems of ownership will have their own roles to play and should work together in grain circulation.

3. The model must help promote cooperation among grain growers in the sphere of circulation, stimulate great development in production of commodity grain and bring about a general balance between aggregate supply and aggregate demand for commodity grain.

4. The model must focus on transforming enterprises that produce and handle grain into more independent economic entities that manage themselves and bear full responsibility for their own profits and losses, create a grain market that is competitive and suited to the needs involved in the development of the socialist commodity economy, and facilitate the state's efforts to employ a general macroscopic regulatory system to effect plan guidance and indirect control over grain production and handling.

## II. The Proper Model for the Grain Circulation System of the Future

The proper model for free grain circulation conducted under state macroscopic regulation and plan guidance is a grain circulation system bearing Chinese characteristics. This model stands between the two extremes of completely free circulation and state allocation, adopts the strengths of these two systems and discards their weaknesses. Free circulation and market competition are prerequisites for the development of commodity economy but invariably engender blindness and profiteering in the marketplace and wide gaps between the rich and the poor, which developments cannot completely be avoided even under socialism. Grain is the most important commodity affecting the national economy and the people's livelihood, and China will not enjoy plentiful supplies of this commodity for a long time to come. Under these conditions, therefore, it is even more essential for us to prevent market blindness and profiteering. Thus the state's macroscopic regulation and plan guidance are required for precisely the purpose of reducing blindness and profiteering to the lowest levels possible.

Under this type of grain circulation system, grain producing units and grain trade enterprises should become independent economic entities possessing the authority to make their own operational decisions, exchange or transfers of grain ownership are to be transacted in various types of markets, and we must adhere to the law of value at each link of grain marketing, from the sale of grain by producers to the purchase of grain by consumers.

Under this system, the state should carry out macroscopic regulation and plan guidance in the following principal areas.

(1) The state should effect its administrative control through government commercial departments, exercise its property rights in state grain marketing enterprises through government departments administering state commercial property, carry out wide-ranging consultation and dialogue through associations of grain handlers and through grain marketing enterprises, and thereby create a new system for administering grain trade that can be used to guide grain marketing enterprises and grain markets. (2) The state must implement guidance plans for the production, procurement and marketing of major grains affecting the national economy and the livelihood of the people and, at specially designated

times, may, in accordance with law, effect mandatory plans for the procurement and marketing of these grains. Grain should be procured and marketed according to plan through state-owned grain companies. (3) The state should establish a grain storage system at many administrative levels. Government grain storage agencies may directly, or indirectly through state grain companies, buy up and sell out large quantities of grain from and on grain markets and thus regulate demand so as to adjust prices on grain markets. (4) The state must use general economic regulatory measures, such as tax rates, interest rates and foreign exchange rates, to regulate grain output, circulation, consumption, imports and exports and to guide grain markets and enterprises producing and handling grain. We must also enable the price mechanism to play its proper role in regulating supply and demand of commodity grain, and we must establish price floors (for producer prices) and ceilings (for consumer prices) for rice, wheat, corn and a small number of other grains so as to protect the interests of both producers and consumers. (5) We must use legislation and appropriate administrative control regulations to establish order in grain markets, properly control wholesale trade and invigorate retail trade and truly assure that control does not become stifling and invigoration does not lead to chaos.

Under this system, China's grain markets on the whole will be state regulated, that is, they will be planned commodity markets, not markets monopolized by the state, as developed in the 1950s, and not normal free markets; even less will they be monopolized by private individuals. These markets will have the following characteristics. (1) The law will forbid any producer or handler to monopolize grain markets. (2) Major products affecting the national economy and the people's livelihood, such as husked rice, wheat, corn and major regional products will be subject to market regulation effected under plan guidance. (3) Minor grains that do not have a great impact on the national economy and the people's livelihood, such as coarse cereals and beans, will be fully subject to market regulation. This structure of grain markets might successfully integrate the positive aspects of plan guidance and of the market mechanism and enable us to achieve a basic balance between grain supply and demand and to effect exchange of equal value, which desiderata are also the goals of state macroscopic regulation of and planned guidance over grain markets.

In conjunction with the aforementioned grain market structure, the state will set planned prices for each region for the major grains subject to both plan guidance and market regulation. Free prices will be permitted for coarse grains and beans, which will be subject entirely to market regulation, and these prices will be set and adjusted by associations of grain dealers in the regions that produce these crops.

This system of grain price management will facilitate the transition to the creation of a rational grain price system. (1) Under this rational system, prices will reflect the

value and production costs of grain as well as the relationships between supply and demand and between grain value and money. We must strive to bring closer into line planned prices, negotiated prices and the markets for the same quality of a single type of grain marketed at the same time. (2) Reasonable differentials between producer and consumer prices will be maintained, and circulation prices will properly and rationally be differentiated for a variety of factors. (3) A system of price floors will be established for rice, wheat and corn that meet procurement quality specifications, which floors should be equal to or a little higher than costs. And a system of price ceilings will be established for specified grades of husked rice, wheat flour and corn meal. It will be difficult to eliminate all state price subsidies for grain during the rest of this century, but the range and size of these subsidies must be regulated by law, and the subsidies should be made clearly and openly and not kept hidden. (4) Rational price ratios between grain and other agricultural produce will be maintained. (5) Some ties should gradually be established between domestic and international grain prices so as to facilitate development of grain import and export trade. In sum, we must gradually create a unified, flexible and integrated system of grain prices.

Under this system, the coexistence of different systems of economic ownership, which has grown up over a long period of time, will continue.

### III. The Coordination of Socioeconomic Relationships in All Facets of the Circulation Process Is Key to the Smooth Progress of Reform in the Grain Circulation System

To ensure that the reform of the grain circulation system progresses normally, we must ensure that the reform proceeds in step with and serves as a complement to the reform of the administrative system of the national economy. Equally important is that we coordinate socioeconomic relationships in all facets of the circulation process. To accomplish this, we must proceed from the following areas.

First, we must protect the earnings of commodity grain producers. The keys to our effort to promote stable expansion in grain production lie in making producer prices rational and in gradually eliminating the practice of using planned procurement prices to redistribute national income. However, the state's financial strength and the people's economic capacity limit our ability to and thus will make it very difficult to make large increases in procurement prices and to effect exchange of equal value in one fell swoop. Still, we must proceed in these directions. For this transitional period, we have no choice but to retain the double-track system of grain prices, but during this period we must gradually increase procurement prices (by region and by crop type) so that these gradually approach market prices, guide market prices [subject of "guide" is vague in original text], and effect exchange of equal value in negotiated prices and in

the pricing of grain on open markets, which prices would be set in discussions between buyers and sellers, so as to mobilize peasant enthusiasm for grain production.

Second, we must protect the reasonable profits earned by commodity grain dealers. To do this, we must maintain a strict separation of government and enterprise activity. Grain subsidization is a government activity, is granted to urban and rural consumers by the government through state grain trading enterprises and is not supposed to be accorded to those enterprises themselves. Grain subsidization is a result of government policy and therefore should not be defrayed out of enterprise earnings but rather should be borne entirely by the government. Grain enterprise profits and losses result from enterprise activity and responsibility therefore should be borne entirely by enterprises. Profits earned through enterprise activity are subject to taxation, and losses so incurred may not be made up through diversion of government subsidies or covered up and explained away as being the result of government policy. Strict separation of policy-mandated subsidies and enterprise profits and losses will pave the way for the separation of government grain administration and grain enterprises and for the change in the status of those enterprises as appendages of government administration and will facilitate ultimate transformation of those enterprises into independent economic entities that have full control over microscopic decision-making.

Third, we must protect the interests of low-income consumers. Some of China's urban and rural consumers have low incomes. According to survey data from the State Statistical Bureau, 20 percent of all urban families have per capita incomes of less than 600 yuan [a year], and 12.3 percent of all peasant families have net per capita incomes of less than 200 yuan. We must continue to provide these consumers with parity priced grain, and we can do so on the basis of the current rationing system, but we should limit such grain to standard rice, standard wheat flour and corn meal. Beyond this, however, we should broaden price differentials for different grain quality and grade so as to meet the demands of consumers of all types.

Fourth, We must control the total amount of subsidies granted. Grain prices will continue to be dependent on subsidies for a long time to come, but subsidies should be stabilized and placed out in the open wherever conditions are ripe. Thus we must start reforming the grain subsidy system, reduce subsidies to a single type and apply them at a single link. Subsidies applied at procurement cover the gap between wholesale procurement prices (procurement price + procurement costs) and allocation prices rendered to grain trading enterprises (unified marketing prices - circulation costs - trade profit). Subsidies applied during sales cover the gap between sales prices (procurement price + circulation costs + trade profit) and unified marketing prices. The Finance Ministry can control the total amount of subsidies granted by simply setting, on the basis of the grain

procurement plan or the plan for unified grain sales approved by the State Council each year, standards for circulation fees and for grain enterprise profits.

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### Rural Statistics Explained

40060064 Beijing NONGCUN CAIWU KUIJI  
[RURAL FINANCIAL ACCOUNTING] in Chinese  
No 11, 6 Nov 87 pp 35-43

[Unattributed article: "Explanation of Indicators in Rural Economic Statistical Reports (Selections)," first paragraph is editor's introduction]

[Text] The General Office of Management of the Ministry of Agriculture, Animal Husbandry, and Fishery has issued "Regulations for 1987 Rural Economic Statistical Reports" whose explanations of indicators differ considerably from the "Explanations of Indicators of Rural Economic Income Distribution" published by this journal in its 1984 issue No. 10. In order to aid the masses of grass-roots personnel in promptly and accurately filling out statistical reports for the coming year of annual rural statistical work, we are publishing explanations of some selected indicators to serve as reference in preparing annual statistical reports around the country.

Number of Households Included: the number of households included in the rural economic statistical tables. This refers to the number of households involved in household operations, centralized collective operations, new integrated economic entities, and two-level village enterprise labor, and earning income from same.

Number of Specialized Households: of the total number of rural households, the specialized households meeting the following four criteria: 1) the household is the unit, and its primary labor force (or most of its able-bodied workers) is engaged in specialized production or spends more than 60 percent of its time in specialized operations; 2) specialized income accounts for more than 60 percent of total household income; 3) its commercialization rate for specialized products exceeds 80 percent (60 percent for specialized grain-producing households); 4) income from sales of products (including service income) is twice the average household income from sales of products in the area (county) in question.

Population Included: the population included in the rural economic statistical tables. This includes those peasants engaging in household operations, centralized collective operations, new integrated economic entities, and two-level village enterprise labor, plus the population dependent for their livelihood on those peasants' income.

Labor Force Included: the labor force included in the rural economic statistical tables. This refers specifically to the number of full- and part-time workers regularly

engaged in household operations, centralized collective operations, new integrated economic entities, and two-level village enterprise labor.

The productive labor or work of the rural labor force during the year in different economic entities is divided up as follows: the labor force engaged in household operations, that engaged in centralized collective operations, that engaged in new integrated economic entities, and that engaged in village enterprises.

1. The labor force engaged in household operations is that portion of the rural labor force engaged in their own household operations. Specifically, this refers to household units whose labor force engages in agriculture, forestry, animal husbandry, sidelines, fishery, industry, transport, construction, the commercial food service industry, and other productive operations (including contractual production)

2. The labor force engaged in centralized collective operations refers to that portion of the rural labor force engaged in productive labor in units conducting centralized operations, centralized accounting, and centralized distribution.

3. The labor force engaged in new economic integrated entities: new integrated economic entities refers to integrated economic entities in which the labor force follows the principles of voluntarism and mutual benefit, integrated operations, and joint management, which have a definite scale, work site, and fixed personnel, and have a relatively stable field of operations, accounting system, and distribution system. In integrated economic entities of a seasonal nature, the period of integration must be at least three months; this does not include individuals or several households in integrated contractual collective enterprises or several projects in a contractual enterprise, nor does it include individuals seeking helpers or individual enterprises taking on apprentices. In counting numbers of integrated entities, those spanning different regions may be counted in the township or village where the entity was formed. The labor force of new integrated economic entities refers to those persons engaged in productive labor in a new integrated economic entity.

4. The labor force engaged in township and village enterprises refers to those engaged in productive labor in two-level village and township enterprises.

Rural Productive Fixed Assets at Year's End: productive fixed assets are those principal means of labor used repeatedly by peasants during the production process yet maintaining their original material form, having a unit value of more than 30 yuan, and used for at least two years.

Original Value of Productive Fixed Assets at Year's End: the original value of productive fixed assets remaining at the close of the year. This is calculated according to the actual costs expended to purchase fixed assets, at the

time of their purchase; this includes purchase price, transport and installation costs, etc. Fixed assets manufactured or constructed by the peasants are in principle figured according to the state's list prices for similar assets. Young animals bred and raised by the peasants to serve as draft animals, breeding stock, or animal products at their maturity are figured according to the market prices for similar stock.

**Original Value of Rural Productive Fixed Assets at Year's End** refers to the original value of productive fixed assets within the statistical range at the close of the year. This is divided into the following four parts according to the type of ownership of the fixed assets:

1. Original value of collectively owned productive fixed assets: this is the original value of productive fixed assets owned by the collective; this includes productive fixed assets that are owned and used by the collective or contracted out by the collective to peasants for use, and those owned by the collective but standing idle or on loan to other units.

2. Original value of peasant-owned productive fixed assets: the original value of productive fixed assets owned by the peasants themselves.

3. Original value of productive fixed assets owned by a new integrated economic entity: the original value of all productive fixed assets owned by the integrated entity at the close of the year. This includes the original value of those productive fixed assets which the member units of the integrated entity have bought shares in or hold themselves, and those which the integrated body itself has accumulated.

4. Original value of productive fixed assets of two-level township and village enterprises: refers to the original value of all productive assets owned by a two-level township and village enterprise.

**Area of Cultivated Land:** cultivated land refers to fields planted in agricultural crops and regularly worked. This includes cultivated land, land newly reclaimed in the year in question, land lying fallow for less than three years, and land idled for the year in question (rotation idling). Land planted primarily in agricultural crops but also bearing mulberry or fruit trees, tea plants, and other trees, and land bordering the seacoast or lakes that has been reclaimed or enclosed, etc., should be included here. Land with specifically designated uses such as mulberry groves, orchards, tea plantations, fruit tree nurseries, forests, reed fields, natural grass plains, etc., is not to be included, however.

**Area of cultivated land** refers to the area of all cultivated land of whatever economic type within the statistical range.

**Area of Land Under Contract:** arable land owned by the collective and contracted out to peasant households or specialized teams, groups, or other units for production.

**Household Income from Operations:** all income earned by peasant households during the statistical year from all operations. Income earned by peasant households from working in centralized collective operations and in village-run enterprises, or in integrated economic entities, is not to be included.

**Two-Level Township and Village Enterprise Income:** income from operations and nonproductive income such as interest and rents earned by two-level township and village enterprises during the statistical year.

**Income from Sidelines:** this includes income earned through cooperative economic activity or individual peasants from hunting and gathering wild plants and animals.

**Income from Industry:** income earned by engaging in industrial production. This includes: handicraft income from manual processing or simple machine processing to produce finished products in the year; agricultural product processing income from the processing into finished products of agricultural and sideline products, such as rice milling, cane sugar making, wine making, oil pressing, cotton ginning, silk reeling, processing medicinal herbs, etc.; income from the processing into finished products of various industrial products during the year; and all income earned during the year by extracting natural resources and processing them, such as mining, felling timber, smelting iron ore, wood processing, etc.

Those products sold are figured according to their actual selling price; income from products processed on commission is figured according to the processing commission.

**Income from Transport:** income from the transport, loading and unloading, and carrying of goods or from the transport of passengers by the unit in question for other units or individuals during the year.

**Income from Construction:** income earned during the year by engaging in the construction and maintenance of buildings and in the installation of equipment.

**Income from Commerce and the Restaurant Industry:** income earned during the year by peasants from the buying and selling of commodities and from the cooking and retail sale of foods. This income is figured as net income, i.e., total income minus expenditures for purchasing commodities and for self-produced raw materials.

**Income from Services:** income earned during the year by members of peasant households by providing labor for everyday services, such as peasant-operated inns, bicycle

repair, watch repair, umbrella repair, the practice of itinerant medicine, barbering, babysitting, etc. Service-related income is figured as income from services minus expenditures.

**Other Income:** all income not deriving from the productive activities described above, such as inventory profit from stored grain and goods, price hikes on products before their sale, interest income and income from rents; this does not include loan income, however.

**Net Income:** the income remaining after "total expenses" are deducted from "total income" for the year.

**Collective Withholding:** this includes the accumulation funds, production cost funds, public welfare funds, and reserve funds withheld by the cooperative economic organization from the directly earned production income, and the various planned monies turned over to the collective by contract households and units.

**Peasant Income:** total income earned by peasants from household operations, centralized collective operations, and the productive activities of new integrated economic entities and two-level township and village enterprises, minus total expenses, state taxes, and collective withholding. Cadre compensation is also included in this heading.

**Amount Owed by Contractors:** the contractual amounts payable according to the terms of the contract to the collective (the party letting the contract) by contract households, specialized contract households, and contract units (this includes remuneration for use of the means of production, a fixed portion of income, or a proportional amount of withholding), accumulation funds, public welfare funds, cadre subsidies, and other management costs.

**Amount Already Paid by Contractors:** the amount actually paid in to the collective (the party letting the contract) on time according to the terms of the contract by contract households, specialized contract households, and contract units.

**Income from Sale of Products:** income from the sale by collective economic organizations or individual peasants to the state or other buyers of agricultural, forestry, livestock, sideline, fishery, industrial, or other products produced that year. This includes income from grain and other products sold to the state in payment of agricultural taxes. It does not include grain consumed by individuals or units themselves or given to friends and relatives as gifts.

**Income from Sale of Agricultural Products:** income from the sale of grain, cotton, oil crops and other plant products by cooperative economic organizations and individual peasants.

**Income from Sale of Forestry Products:** income from the sale of forestry products in the form of saplings or wood and bamboo obtained by cultivation but without felling. This includes income from the sale of raw lacquer, palm fiber, gallnuts, rosin, tung seeds, dried bamboo shoots, walnuts, Chinese chestnuts, etc. It does not include income from the sale of mulberry leaves, tea leaves, fruits, or wild forest products.

**Income from Sale of Animal Products:** income from animal products sold during the year by cooperative economic organizations and individuals to the state, the collective, and to individuals. This does not include those products consumed by the peasants themselves.

**Income from Sale of Sideline Products:** income obtained from the sale of hunted wild animals and gathered wild plants.

**Income from Fishery Products:** income obtained during the year by the sale of harvested aquatic products (includes aquatic products raised and harvested as well as those produced naturally and caught) to the state, the collective, and to individuals.

**Income from Sale of Industrial Products:** income obtained from the sale of finished and semi-finished industrial products.

**Income from Sale of Other Products:** income obtained from the sale of products other than those described above by cooperative economic organizations and individual peasants.

#### **Explanation of Indicators for Village (Commune) Balance Sheets**

The statistics in these forms reflect only the financial situation of cooperative economic organizations (including agricultural collective economic organizations such as agricultural producers' cooperatives established with administrative villages, natural villages, or former production teams as the unit); this does not include the financial situation of village (cooperative) enterprises, contract households, or contract units.

**Fixed Assets:** all assets used for more than two years having a unit value meeting the established criterion (generally over 30 yuan). Assets not meeting these two conditions should be treated as low-cost and short-lived articles. However, certain principal production tools and equipment in use for more than two years, even though not meeting the established value criterion, may also be listed as fixed assets depending on provincial, regional, or municipal regulations.

**Capital Construction Expenditures:** expenditures by villages (cooperatives) to establish orchards and to construct buildings, warehouses, water conservancy works, etc.



**Production Costs Carried Forward:** costs incurred by the village (cooperative) this year and to be amortized or closed out according to regulations next year, such as expenditures to be amortized for overhaul or for low-cost and short-lived articles, and costs incurred for products or perennial crops for next year's harvest.

**Outside Investment:** equipment, products and materials, and monetary funds invested by the village (cooperative) in outside units for joint or cooperative operations. This includes investments in enterprises and subscribed treasury bonds.

**Investments in Enterprises:** property, goods, and monetary funds invested by the village (cooperative) in any joint productive operations with state-run or urban collective enterprises, town and township enterprises, and private enterprises. This includes money paid by the village (cooperative) for shares held in outside units, and production operating funds advanced to its enterprises; it does not include property, goods, or monetary funds loaned to or allocated without compensation to its enterprises.

**Allocated Enterprise Funds:** all products, materials, and monetary funds allocated by the village (cooperative) to its enterprises without compensation.

**Balance Due from Outside Units and Individuals:** the amount of claims against units and individuals outside the village (cooperative) by the village (cooperative) collective. This includes all monies loaned to outside units and individuals, all suspense debits receivable, etc. Collective property serving as payment and receivable by the village (cooperative) is not included here.

**Balance Due from Households in This Village (Commune):** the amount of claims by the village (cooperative) collective against peasant households in this village (cooperative). This includes all monies and suspense debits receivable by the village (cooperative), such as collective loans by peasant households from the village (cooperative), contractual income and withholding receivable from peasant households, and production circulating funds advanced to peasant households. Collective property issued as payment, payable but not yet paid by peasant households, is not included here.

**Production Circulating Funds Advanced to Peasant Households:** all production funds provided without compensation by the village (cooperative) to the contract households according to contract, to be used for production turnover. This does not include loans issued to contract households and to be repaid.

**Uncollected Collective Property Issued as Payment:** collective property issued as payment refers to some collective property given by the village (cooperative) to its contract units and individuals as payments, following introduction of the contract responsibility system in agriculture in order to adapt to its characteristic of the

household being the chief operating unit. Uncollected property issued as payment refers to property issued as payment by the end of the present year, receivable but not yet received.

The amount of this indicator added to the "cumulative amount of collective property issued as payment and already collected" should equal the total amount of collective property issued as payment by the village (cooperative).

**Cash and Deposits:** cash on hand in the village (cooperative) and the balance of deposits in banks or credit cooperatives at the end of the year.

**Products and Materials:** balance of products and materials in stock at the end of the year in the village (cooperative).

**Village (Cooperative) Funds:** all funds owned by the village (cooperative) and used for production. This includes collectively owned funds converted to household shares, socialized share funds paid by members joining the cooperative, production funds allocated without compensation by higher authorities, and funds from collective withholding newly applied to production.

**Uncompensated State Allocations:** fixed and circulating funds allocated by the state without compensation to support village (cooperative) production and operations. Fixed funds are figured according to the net value of fixed assets.

**Household Share Conversion Funds:** with ownership of collective funds remains unchanged, those village (cooperative) funds consisting of the collectively owned funds of the former production teams converted to shares for the households.

**Collective Withholding:** all planned monies withheld by the village (cooperative) from contract units and individuals, and accumulation funds, public welfare funds, and other specialized funds withheld from the year's collective income.

**Accumulation Funds:** accumulation funds out of collective withholding used to expand reproduction. This includes accumulation funds retained by the village (cooperative) from the distribution of collective profits, collected fixed-asset depreciation funds, income from the sale of fixed assets at the current price, income from the scrap value of discarded fixed assets, compensation for state occupancy of land, etc.

**Public Welfare Funds:** funds from collective withholding used to support the five household guarantees, dependents of military heroes, families with material difficulties, subsidies for teaching staff in people-run schools, and the provision of collective welfare services. This

includes public welfare funds retained from the distribution of profits, income from village- (cooperative-)run collective welfare services, educational, health, and welfare costs and social relief funds allocated by the state and higher authorities, etc.

**Village (Cooperative) Planned Monies:** all planned monies collected by the village (cooperative) from the relevant unit or individuals in the village (cooperative) in the form of public welfare funds, accumulation funds, and management costs. This includes management costs paid according to regulation by village- (cooperative-)run enterprises.

**Investments from Outside:** all equipment, products, materials, and monetary funds invested in the village (cooperative) by units and individuals outside the village. This includes funds raised by the village (cooperative) by capital formation and other means, share funds subscribed by outside units or individuals in the village (cooperative), etc. However, this does not include direct investment in village (cooperative) enterprises.

**Bank Loans:** the balance at year's end on all monies borrowed by the village (cooperative) from banks or credit cooperatives.

**Balance Owed to Outside Units and Individuals:** loans, amounts payable, and suspense debits owed by the village (cooperative) to outside units and individuals, and monies held in trust, such as down payments for advance purchases of agricultural and sideline products, dividends payable, water and power costs payable, purchases payable, taxes payable, etc.

**Balance Owed to Peasant Households in the Village (Cooperative):** loans, amounts payable, and suspense debits owed by the village (cooperative) to peasant households in the village (cooperative), such as management costs payable, labor remuneration and dividends payable, etc. This does not include any balances owed to peasant households in outside villages (cooperatives), however.

**Net Value of Collective Property Issued:** the net book value of all collective property turned over to the relevant units and individuals by the village (cooperative) since the introduction of the contract responsibility system in agriculture. For villages (cooperatives) using the depreciation system for fixed assets, fixed assets are figured according to the net value after subtracting depreciation from the original value. For those not using the depreciation system, they are figured according to the present value at the time of issue. Nonfixed property and materials are also figured at present value.

**Cumulative Amount of Collective Property Issued as Payment and Already Recovered:** the total amount of property issued as payment and already recovered as of the end of the year, i.e., total amount of property as payment recovered over the years.

**Total Number of Villages (Cooperatives):** the total number of villages (cooperatives) in all provinces (regions, municipalities).

**Number of Villages (Cooperatives) Included:** the unit number of villages (cooperatives) in all the relevant indicators for all the financial situations reflected in this form.

**Total Number of Able-Bodied Farm Workers Included:** the total number of able-bodied workers in the villages (cooperatives) included in this form.

#### **Explanation of Indicators for Village (Cooperative) Income and Use Tables**

The statistics in these tables reflect only the income and expenditure of village cooperative economic organizations (including agricultural production cooperatives and other agricultural collective economic organizations established with administrative villages, natural villages, or former production teams as the unit); they do not include income and expenditure of village (cooperative) enterprises, contract households, and contract units.

**Annual Income:** net income from all sources earned by the village (cooperative) during the year. This includes net income from all production operations engaged in by the village (cooperative) collective, contractual income paid in by contract units and individuals, dividend income from shareholding and participation in joint operations, all village (cooperative) planned monies, allocations from higher units, other income, and balances from last year.

**Net Income from Village (Cooperative) Collective Operations:** net income (total income minus total expenses) from all production operations earned during the year by the village (cooperative) through collective operations.

**Contractual Income:** actual amount turned over during the year by contract units and households to the village (cooperative) according to contract. This includes profits turned over according to regulation by village- (cooperative-) run enterprises.

**Net Income from Joint Operations:** net income and dividend income earned by the village (cooperative) during the year through participation in all forms of joint and cooperative operations.

**Planned Village (Cooperative) Monies:** all planned monies collected by the village (cooperative) during the year from the relevant units such as enterprises and individuals within the village (cooperative) in the form of public welfare funds, accumulation funds, and management fees. This includes management fees paid by village- (cooperative-)run enterprises according to regulation.

**Allocations from Higher Units:** all monies allocated to the village (cooperative) during the year by higher units such as the state, the township, the village, etc. This includes production and operating circulating funds and fixed funds given in support without compensation, as well as allocations for education, health, and other welfare services and social relief.

**Other Income:** all income not included in the above items. For example: rental income, income from interest on deposits, income from inventory profits and price hikes on products and materials last year, income from all types of fines, and income from subsidies granted by the relevant units.

**Balance from Last Year:** the balance left after subtracting last year's expenses and distribution to the peasants from last year's income.

**Expenditures During the Year:** actual expenditures by the village (cooperative) during the year, including expenditures used in collective operations to expand reproduction, taxes, all types of subsidies and outlays, provision of collective welfare services, etc.

**Expenditures Used in Collective Operations to Expand Reproduction:** expenditures in collective operations to expand reproduction through the purchase of machinery used in production and to construct buildings and warehouses used in production.

**Administrative and Management Expenses:** all expenses by the village (cooperative) during the year in the area of administration and management, such as office equipment, account books and forms, postal and telecommunications services, books and newspapers, lighting, per diems, depreciation and maintenance on fixed assets used in management, etc.

**Taxes Paid:** actual amount of all taxes paid during the year by the village (cooperative) to the state. In the case of tax reductions or exemptions, the actual amount after the exemption is to be entered. This does not include any taxes paid by contract households or units on their own.

**Withholding Paid:** management fees and all planned monies paid by the village (cooperative) to the responsible departments above the township level.

**Contractual Subsidies:** expenditures actually made according to the terms of the contract by the village (cooperative) without compensation to contract units for contractual services in order to encourage development of production and construction. This includes such expenses as providing mechanical irrigation and labor services without charge, goods and funds provided without compensation, etc., and other forms of expenditures to support contract units. This does not include advances by the village (cooperative) for production circulating funds for contractual services.

**Outside Investment:** outlays by the village (cooperative) during the year for joint or cooperative operations with outside units (including the state, collectives, and individuals), including such investments as purchase by the village (cooperative) of treasury bonds and joint projects.

**Investment in Village (Cooperative) Enterprises:** funds actually expended by the village (cooperative) during the year in the form of allocations to its enterprises for the purchase of fixed assets or to increase circulating funds.

**Construction of Village (Cooperative) Water Conservancy Installations:** actual expenditures by the village (cooperative) during the year for the construction of water conservancy works.

**Initiation of Village (Cooperative) Collective Welfare Services:** outlays by the village (cooperative) during the year to undertake collective welfare services, such as nurseries, child-care centers, homes for the aged, etc.

**Cadre Subsidies:** subsidies by the village (cooperative) during the year for cadres in the village (cooperative).

**Subsidies to Dependents of Military Heroes, Five-Guarantee Households, and Households with Material Difficulties:** expenditures by the village (cooperative) during the year to care for the village's (cooperative's) dependents of military heroes, five-guarantee households, and households with material difficulties. This includes medical costs for the injury or death, welfare assistance, and pensions for cooperative members.

**Education and Health Expenditures:** expenditures by the village during the year to develop education and health facilities in the village (cooperative). This includes aid to the construction of school buildings and people-operated classes, family planning, etc.

**Other Expenditures:** this includes expenditures other than those listed above.

**Distribution to Peasants:** profits distributed during the year by the village (cooperative) to its peasant households; this includes remuneration for labor and dividends from joint operations or investments.

**Balance for the Year:** the balance remaining when the village's (cooperative) expenditures and distribution to peasants during the year are subtracted from its income during the year.

**Number of Villages (Cooperatives) and Able-Bodied Workers Included:** this is the same as for "Number of Villages (Cooperatives Included)" and "Number of Workers Included" in the explanations for the balance sheets.

### Fluctuations in Pork Production and Marketing Analyzed

40060096 Beijing NONGYE JINGJI WENTI  
[PROBLEMS OF AGRICULTURAL ECONOMY] in  
Chinese No 11, Nov 87 pp 30-33

[Article by Zhou Binbin [0719 1755 1755] and Zhang Hongyu [1728 4767 1342] of the Policy Laws and Regulations Department of the Ministry of Agriculture, Animal Husbandry, and Fishery: "Fluctuations, Causes, Strategies—Basic Findings on the State of Pork Production and Marketing"]

[Text] The focus of this article is to analyze the underlying causes of fluctuations in pork production and marketing, and, on this basis, to issue our findings and propose corresponding strategies for dealing with them.

I. Right now pork production and sales nationwide are in a distinct state of flux marked by the following characteristics:

A. Growth in the total volume of pork supplies has slowed, whereas the total volume of pork sales has risen rapidly, and the gap between production and sales is broadening. According to statistics, in the first half of 1987 China produced a gross output of 8,686,000 tons of pork, up 87,000 tons over the 8,599,000 tons produced in the same period of 1986. Production grew only 1 percent, while consumption grew 11.9 percent during the same period of time. To meet consumption we had to draw upon reserves. As of the end of June, the number of porkers on hand had dropped to 15.28 million head, down 28.3 percent compared with the same period of 1986. It is worth noting, however, that the increase in pork consumption in the first half of 1987 was somewhat out of the ordinary. From 1983 to 1986 the average index of growth in pork consumption was 6.41 percent, rising to only 8.53 percent when grain conversion was vigorously promoted in 1984. But in the first half of 1987 the index of growth in pork consumption not only surpassed the average previous level, it even vastly exceeded the 1984 high. There were two causes behind this extraordinary growth: First was the "compulsory" substitution of pork brought about by shortages of similar foods. In Beijing, for example, growth in pork sales in the Beijing Market fell within the normal range all the way through April. But in May, after we began to depend on local egg supplies, purchasing power began to focus on pork and this gave rise to a major increase in sales volume. By June the cumulative total of pork sales had grown 14.6 percent over the same period of 1986. Second, the shortage of pork supplies led city residents to "feel deprived," and this in turn stimulated growth in pork sales. These two points are both short-term factors. So long as pork supplies are restored to normal, consumption increases will stabilize at a "conventional" level.

B. There were no distinct fluctuations in hog production in the first half of the year, but in the latter half of the year the prognosis is that the situation will change and in fact hog production will decline and affect next year's pork supply. Although the overall supply of pork did not decline in the first half of this year, and in fact increased somewhat, a decline in hog production capacity has begun to appear. For one thing, because the marginal benefits of hog farming have declined, farmers will commonly be slaughtering early, liquidation of inventories will increase, and the quantity of stock on hand will decrease, leading directly to a weaker hog supply capacity in the latter half of the year. The average live weight of porkers slaughtered in Hebei dropped from 90 kg per head in previous years to 70 kg per head in January through May of this year. In Hunan, on the other hand, the average live weight declined from 94.4 kg in 1986 to 84.96 kg in 1987. This is equivalent roughly to 700,000 fewer hogs slaughtered. Comparing the stock of swine on hand in the latter half of 1987 with that on hand in 1986, we see a decline of 5,656,000 head, or 1.7 percent. In the second place, the number of brood sows has dropped dramatically. There are 2,296,000 fewer sows on hand this year than in 1986—a decline of 9.6 percent. The percentage of brood sows in the total hog population declined from 7.5 percent in the same period of 1986 to 6.9 percent this year. This proportion is lower than the ordinary standard necessary to maintain hog reproduction capacity. Quite obviously, early slaughtering leads to insufficient sources of hogs. A drop in the quantity of sows on hand also directly restricts our chances of expanding the hog supply as quickly as in the past. The above two factors together constitute the direct cause of fluctuations in hog farming productivity in the latter half of this year. According to projections made by the Animal Husbandry Bureau of the Ministry of Agriculture, Animal Husbandry, and Fishery, by the end of 1987 the three basic indicators of hog production—stock on hand, stock slaughtered, and pork output—will have declined since the previous year, by 4.1 percent, 0.1 percent, and 2.6 percent, respectively. By winter, the busy season for pork marketing, the supply and marketing situation will be much more serious, and it is a foregone conclusion that the gap between supply and demand will grow. Because of the decline in the number of stock on hand at the end of the year, this period of fluctuation may continue until the end of 1988 and affect pork supplies for the whole year.

II. The causes of these fluctuations can be divided into two levels:

Surface causes: Inflation in feed costs increased the cost of raising pigs, leading directly to a drop in marginal benefits. According to statistics from some provinces and cities, composite feed prices rose about 28 percent in the first half of 1987, and production costs increased around 30 percent, but the scale of adjustment on hog procurement prices was far lower than the level of cost increases. The price parity between grain and hogs is becoming unreasonable. In Hunan, for example, the

price parity between grain and hogs was 10:1 in the 1950's, 8:1 in the 1960's, and 7:1 in the 1970's, and it has dropped to 5:1 now. In some regions it has fallen to less than 4:1. In 1986 the Animal Husbandry Bureau of the Ministry of Agriculture, Animal Husbandry, and Fishery surveyed 274 hog farmers in 16 counties. In 1985 the net profit on each hog was 29.26 yuan, and in 1986 it was only 9.9 yuan. A hog farmer's income is not even comparable to the lowest income earned by a grain farmer. Unavoidably, the steep drop in income for hog farmers has sent hog production into a tailspin.

An analysis of the economic returns on hog farming can illustrate the direct causes of the downturn in hog production, but it is difficult to come up with good countermeasures working only from objectively expressed causes. Using this method we can only simplistically conclude that raising prices—that sensitive issue—is the best strategy, and thus it is easy to go up a blind alley. Consequently, we must analyze the deeper causes that determine hog production capacity.

A. The most fundamental cause of fluctuations in hog production is the change from guaranteed resources to restricted resources. To a large extent, fluctuations in hog production, which depends primarily upon grain feed, originate in the bumper harvests and crop failures that occur in grain production. Since the PRC was founded, hog production has always risen and fallen in concert with fluctuations in grain output. Their degree of correlation reaches 0.90 or more. The record-breaking bumper harvest of 1984 led to a high rate of growth in hog production, and the next year's pork output also set a new record. Pork output rose from 14,447,000 tons in 1984 to 16,647,000 tons in 1985—a net increase of 2.20 million tons, or 15.2 percent. However, three successive years of fluctuations in grain production followed 1984, and this made it very difficult to sustain the scale of hog production founded upon 1984's bumper harvest. Because the scale of hog production continued to grow through 1986 at the brisk rate of 8.5 percent per year, the conflict between the scales of feed supplies and hog production was further exacerbated. Under inadvertent government regulation and control—through automatic adjustment to prices—this conflict spontaneously forced hog farming to adapt in scale to the new state of grain supplies. Reductions appeared nationwide in the scale of hog production.

B. The irrational mix of livestock and poultry not only lowers our chances of increasing the supply of livestock products at existing feed supply levels, it also exerts new pressures on our efforts to close the gap. Right now, pork output accounts for half of all meat, milk and egg output in China, and it represents over 95 percent of all meat output. This low-return, high cost, hog-centered mix of livestock has increased the demand for feed but correspondingly decreased supplies of livestock products. In 1985, for example, outputs of meat, milk, eggs, and fish in China and their corresponding feed conversion rates were as follows: pork accounted for 48.09 percent of total

output, with a grain-to-meat conversion ratio of 5-8:1; fowl accounted for 4.66 percent of total output, with a grain-to-meat conversion ratio of 3:1; eggs accounted for 15.54 percent of total output, with a grain-to-egg conversion ratio of 3- 3.5:1; milk accounted for 8.43 percent of total output, with a grain-to- milk conversion ration of 1.5-2:1; freshwater fish and shrimp accounted for 8.14 percent of total output, with a grain-to-fish conversion ratio of 1.5:1. As the above figures illustrate, livestock and poultry output and grain conversion ratios in China form an inverse pyramid. The higher the conversion ratio, the lower the percentage of output; the lower the conversion ratio, the higher the percentage of output. Together, the fundamental contradiction formed by this irrational mix of livestock varieties and the shortage of grain supplies produce simultaneous repercussions in the form of fluctuations in hog production and marketing. Not only this, but inadequate supply of other kinds of products exerts new pressures on hog supplies, and abnormal growth in consumption appears, exacerbating the impact of those fluctuation.

C. From the beginning, the hog farming industry, basically characterized by traditional household rearing methods, restricted the "limits" of expansion in hog numbers and made it difficult to meet consumer demands on the quantity and quality of pork. Right now, small- scale production in the household farming industry is facing profound conflicts. One conflict is that the advantages of "sideline style" rearing methods are limited. Using these methods, although we can form a huge hog-rearing base (raising one to two hogs per household, in 180 million households), it is hard to form an effective supply for expanding the volume of new commodities. If the number of hogs being raised by farm households exceeds the number that can be raised by making full use of household leftovers and the byproducts of grain processing, the advantages of this sideline industry are presently attenuated. Conversion costs rise, and the marginal benefits correspondingly decline. A second conflict is that the growth of nonagricultural industries and the increase of opportunity costs brings about a decline in hog farming in developed regions. Many peasants have already been transformed from hog producers to pure pork consumers. In Yantai Prefecture, Shandong, non-hog-farming households already account for 29.5 percent of all peasant households. This phenomenon has also appeared in other developed coastal regions. A third conflict is that the demand for livestock products has shifted from high-fat products to low-fat, high-protein products, and this has made traditional feeding methods and fodder quality unsuitable. It is quite obvious that even though we still need to use the advantages of traditional household hog-raising to ensure a certain scale of production in the hog farming industry, we cannot rely on them to satisfy the higher requirements suggested by the change in economic circumstances, nor to spur steady growth in the volume of pork commodities. The weakness of semi-self-supporting small-scale stock farmers themselves has made it hard

for them to maintain a high level of commodity production: they lack the necessary stability. When there are good prospects for gain, commodity production develops. But as soon as the situation changes, the scale of commodity production shrinks or peasants revert altogether to self-sufficient production. Tens of thousands of households, rising and falling together, directly contribute to the flowing undulations in hog production, exacerbating and making it difficult to control fluctuations in production and marketing.

III. This description of fluctuations and analysis of their causes leads us to conclude that, right now, the key to resolving these fluctuations in production and marketing lies in choosing strategies that essentially help to solve the fundamental conflicts behind them. The focus should be on developing moderate and long-term hog production capacity. These basic strategies are as follows:

A. To develop the hog-farming industry, we must convert from the traditional, extensive pattern of numerical expansion to a pattern of production based on scientific and technological progress and dissemination. With this production pattern, we should achieve the "three high's": high slaughter rate, high body weight, and high lean meat ratio. To adapt to China's future natural resource conditions, the scale of pig production will best be limited to 300 million head.

B. Readjusting the mix of livestock varieties is an essential strategic choice. Given the gloomy prospects for hog farming, we must promote a "white revolution," formulate a plan to provide maximum aid for poultry development, quickly expand the proportion of poultry in our livestock mix, and improve the quality and efficiency of the livestock production system. The current fluctuations in hog production and marketing provide a good opportunity for restructuring. We should not overconcentrate on ways to restore hog production, but instead focus on aiding growth in the poultry and aquatic breeding industries. The growth period for a pig is one year, whereas for a chicken it is only 3 months. Considered from the perspective of shortening the fluctuation cycle, raising chickens is much faster than raising pigs. Right now, our accustomed, traditional emergency measures are to decrease the subsidy and feed grain at the same time. This limits us to a very narrow choice of strategies and reduces their effectiveness to just a temporary stabilization of market fluctuations over a limited time and space. It also ignores the effects and benefits that can be gained by making timely choices and relegates us to seeking only to solve the most pressing emergencies. At best, this is only a shortsighted, intensely pragmatic commercial strategy. But if we change the direction of our thinking and use an equal quantity of subsidy and feed grain to develop high-efficiency, low-cost livestock varieties, we can gain more livestock products. Moreover, because this choice is in keeping with the development of a superior production structure, it will both help to enhance our overall supply

capacity and lay a good foundation for prolonging the arrival and reducing the impact of the next cycle of fluctuations. At the same time, the pluralization of our food sources may decrease the proportion of pork consumption and alleviate the demand to increase pork consumption in conjunction with an increase in purchasing power.

C. We must reform the cropping system and improve the ratio of feed resource utilization. With the cropping system in mind, the basic concept here is to fundamentally change the traditional pattern, which was to use grain conversion to develop the livestock industry. The feed industry is the medium for converting grain into livestock products, but by reforming the cropping system we seek a basic change in the grain conversion pattern. We seek to work directly through the farming system—at a basic rather than intermediate level—to open the main channels for increasing feed supplies and improving the efficiency of energy utilization. This is so we can free ourselves from the dilemma of having to choose between guaranteeing to meet the demand for livestock products and reducing the decline in the energy utilization ratio. The essential points of reform are as follows: 1) We should set aside 200 million mu of China's existing arable land for special cultivation of feed crops. Particularly in hog-farming base counties, we should integrate base construction with reforms in the cropping system and form a tripartite planting composition of grain, cash crops, and fodder crops. 2) Cultivation should be composed of "two decreases and two increases": we should decrease energy feed, increase protein feed, decrease low-energy feed, and increase high-energy feed. Reforming the cropping system is extremely significant for improving the supply of hog feed and developing hog production. This is a major policy, and we must resolve to accomplish this reform.

D. We must master the pattern of fluctuations in pork production and marketing and strive to alleviate its affect on stable growth in the hog-farming industry. In view of the enormous effect that the current fluctuation has had in decreasing on the number of sows on hand, in order to maintain the hog population's capacity to regain former levels quickly, the state and each locality should establish "emergency stores of feed for sows," which would then be supplied at low cost to feed sows during market fluctuations. Simultaneously, the state should set aside a certain amount of feed grain at par each year to give to animal husbandry departments. This would be used to develop livestock breeding farms and livestock breed improvement farms to ensure that livestock quality will improve year after year.

E. To facilitate this change in our pig production pattern, we must act in accordance with the features of natural resource conditions and household stock raising in China. The foundation for growth in hog production must be laid through specializing and commoditizing stock raising among tens of thousands of peasant households.

Right now our policy should focus on effectively improving the degree of organization in socialized production. Animal husbandry departments should think of ways to control obstructions in the system. They should employ the format of either a corporation or a cooperative organization to organize production, marketing, and services among specialized hog-farming households and establish a stable system of hog production.

F. We must insist on reforming the field of circulation by delaying price deregulation and first reforming the management system. The first stage of reform should focus on prices, but because the system of circulation management has not been changed, price reform will lack organizational guarantees and management support, and it will be difficult to intensify or consolidate reforms. Therefore, further price reforms must be put into effect in coordination with management reforms. If we look at Guangzhou's successful experience with reforms, we see that thoroughgoing reform in food management departments should make all five links in the chain—procurement, wholesaling, processing, refrigeration, and retailing—mutually independent. We should also put operating contracts into effect, allow the freedom to stock goods and set prices, encourage competition, and accomplish a complete transformation of multi-channel operation.

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**Income Disparities Among Peasants in Xinjiang**  
40060042 Beijing *NONGYE JINGJI WENTI*  
[PROBLEMS OF AGRICULTURAL ECONOMY] in  
*Chinese No 10, 23 Oct 87 pp 39-43*

[Article by Zhang Pingquan [1728 1627 0356] of the Xinjiang Autonomous Region's Bureau of Statistics: "Discussion and Evaluation of Peasant Income Disparities in Xinjiang."]

[Text] Existing Disparities

Based on sample surveys of villages in the autonomous region, we can look at actual income disparities among Xinjiang's peasants from different angles, using different methods of calculation.

1. The three major disparities among the peasants: The first major disparity is the gap between the rich and the poor. We divide the peasant households into four classes based on wealth: households with per capita net income of below 200 yuan are classified as poor; those with net income between 200-500 yuan are subsistent; those with income between 500-1000 yuan are comfortable, and those with per capita net income over 1000 yuan are well-off. Using these definitions, the net income of the region's peasant households and the percentage of households in each class are as follows:

Year	Per Capita Net Income for the Whole Region (Yuan)	Wealth Classification of Xinjiang's Peasant Households							
		Poor Households		Subsisting Households		Comfortable Households		Well-To-Do Households	
		Percentage	Net Income (Yuan)	Percentage	Net Income (Yuan)	Percentage	Net Income (Yuan)	Percentage	Net Income (Yuan)
1981	235.82	43.12	123.52	53.13	334.34	3.75	-	-	-
1982	277.28	23.13	131.48	68.12	342.25	8.75	-	-	-
1983	307.28	22.91	127.46	65.21	346.63	11.67	742.05	0.21	1194.40
1984	362.65	16.66	129.71	63.75	348.79	17.51	738.32	2.08	1173.69
1985	394.30	16.13	126.38	59.59	348.91	21.70	743.42	2.58	1204.27
1986	419.88	12.02	128.51	57.17	349.53	27.50	704.74	3.31	1932.91

Note: Percentages for comfortable households in 1981 and 1982 include well-off households. Due to incomplete data, net income is not calculated.

This table reflects three problems. First, there is a significant income gap between poor households and well-to-do households. In 1986 the latter received 15 times the income of the former, and the annual income was 1,804 yuan higher. In 1980 income of poor households was 47.62 percent below average, but in 1986 it fell to 69.39 percent below average. Second, the number of poor households is decreasing every year. The percentage dropped from 43.12 percent to 12.02 percent in 5 years; conversely, comfortable and well-off households increased from 3.75 percent to 30.81 percent. Subsisting

households remain the majority, and the distribution of income is basically normal. Third, the actual share of poor households is fairly large. In 1986, 12 percent of the peasant households had income of about 100 yuan; they can barely support themselves, and some are dependent on government welfare.

This comparison of the different classes is an "average" obtained by "throwing out the highest and the lowest numbers." In reality, in many counties there are large

numbers of very well-off "10,000-yuan households" or even "100,000-yuan households." There is a tremendous gap between these households and the poor households which earn very little money annually.

The second major disparity is the north-south disparity, that is, the income gap between north Xinjiang and south Xinjiang. Xinjiang has always been a backward region, and south Xinjiang is the virgin land of this underdeveloped region. One reason is the natural environment. South Xinjiang borders the Takla Makan Desert; it is a desolate place with annual rainfall of less than 100 mm. Arable land is limited, averaging 4.1 mu per agricultural population, which is 3.4 mu less than in north Xinjiang. The soil is sandy and badly salinized,

and as a result, output is low despite the high input. Two, transportation and communication are poor. Three, the educational standard is low. According to surveys, out of 100 agricultural workers in south Xinjiang, 76.48 are illiterate, semi-literate, or had primary school education. This is 9.66 persons more than in north Xinjiang. Only 17.01 out of 100 had junior middle school education, which is 8.58 fewer than in north Xinjiang, and only 6.45 persons had high school education, 0.89 fewer than in north Xinjiang, and only 6 out of 10,000 persons had college or polytechnic education, 20 fewer than in north Xinjiang.

Income disparities between peasants in the north and the south are as follows:

	Per Capita Net Income (Unit: Yuan)						
	1980	1981	1982	1983	1984	1985	1986
All Xinjiang	200.77	235.82	277.28	307.28	362.65	394.30	419.88
South Xinjiang	102.01	229.97	229.15	302.85	302.71	328.55	360.01
North Xinjiang	235.47	241.06	319.35	311.67	423.21	456.80	499.64
South Xinjiang's Lower Income, /	31.20	4.60	28.24	2.83	28.47	28.08	27.95

Since entering the 1980's, south Xinjiang's income level has been lower than north Xinjiang's. In addition, south Xinjiang's income tends to fluctuate and is unstable. Income jumped in 1981 and 1983, respectively followed by a year of zero growth. After each jump the income gap between north and south closed, only to widen again to the previous level in the following year. Relatively speaking, in the 6-year period, the difference in per capita income increased from 73.46 yuan in 1980 to 139.63 yuan in 1986, or an increase of 90.08 percent.

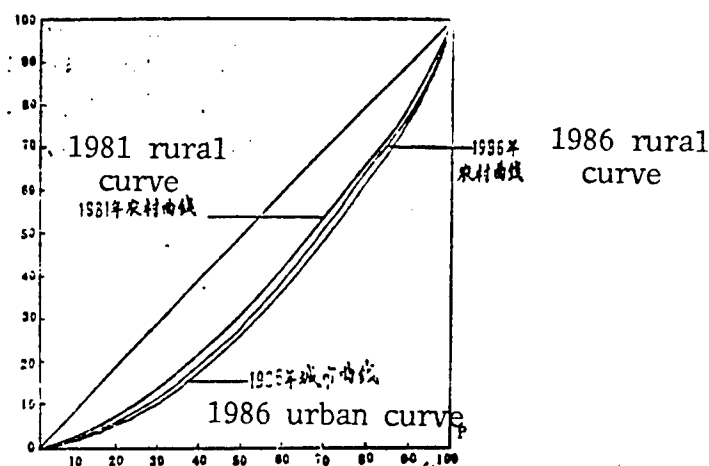
The third major disparity is the disparity between agriculture and animal husbandry. There has been a long history of income difference between peasants and herdsmen due to differences in occupation, social environment, and lifestyle, as well as differences in policies and product prices, among others. Most of Xinjiang's herdsmen are nomadic. They use only one method of production and it is primitive. They have no other source of income than their livestock. They are heavily dependent on the natural economy. Except for the need to sell their livestock in the market and to purchase food grains and other daily necessities, they are practically self-sufficient. In addition, most of them live in remote areas with poor transportation. Earning money is extremely difficult. For these reasons, the herdsmen's income has always been lower than the peasants'. Based on a 1985 survey in portions of the autonomous prefecture and counties, a comparison of the income of peasants and herdsmen is as follows:

Prefectures, Counties	Herdsmen, Net Income (Yuan)	Peasants, Net Income (Yuan)	Income Ratio, Herdsmen: Peasants
Ili Prefecture	266	370	1:1.39
Tacheng Prefecture	249	484	1:1.94
Hami Prefecture	495	387	1:1.98
Bayingolin Prefecture	334	405	1:1.21
Habahe County	273	373	1:1.37
Jinghe County	243	513	1:2.11
Manas County	250	517	1:2.07

From the table, we can see that peasant income is more than double the income of the herdsmen in some counties. That is not all: given the same income, expenditures of the herdsmen far exceed the peasants'. Based on minimum living expenditures, a herdsman needs approximately 550 yuan per year, or three times what a peasant needs.

2. A geometric figure showing vertical and horizontal comparisons. The Lorentz Curve is used widely throughout the world to determine the equity of income distribution in a society. It visually describes the dispersion of income as well as changes in distribution.





In the diagram, the vertical axis OI represents percentage of aggregate income, the horizontal axis OP the percentage of population. The diagonal line OY is the absolute equality curve. This is where a certain percentage of the total population receives the corresponding percentage of total income, that is to say, it represents a condition where income is equally distributed among all people.

Conversely, the line connecting OPY is an absolute inequality curve where one member of society receives all the income and the rest get nothing.

In reality, neither of the above lines exists because it is impossible for everyone to receive the same income or for one person to receive all the income. Therefore, the real curve, the actual income distribution curve, is somewhere between OY and OPY. The closer it is to OY the more equal the income distribution, and the further away, the more unequal.

For simplicity we have chosen to compare, vertically, the first years of the "Fifth 5-Year Plan" and the "Sixth 5-Year Plan", and horizontally, the income of peasants and the urban population. The result of our calculations is shown by the three Lorenz curves in the diagram above.

The diagram clearly shows a greater dispersion of peasant income in 1986 than in 1981. Comparing the rural curve to the urban curve, the curve representing urban income has a wider arc at the bottom but tapers off faster at the top than the curve representing the 1986 peasant income. This means that the income of a portion of the low income urban population is proportionally lower than the low income peasants, but a portion of the urban population has a much greater percentage of the total income than the peasants. There are huge income differences, and they are more pronounced in the urban population than among peasants.

3. Quantitative differences as reflected by the Gini coefficient. The Gini coefficient is an index derived by C. Gini, an early 20th century Italian economist, based on the Lorenz curve to determine the degree of equality in the distribution of income. It reflects fairly accurately the distribution of income among the peasants as a group, and detects fairly accurately even small changes in income dispersion. It has wide applications internationally and is an important economic parameter when considering national policies. Its standard for measuring income dispersion is, the larger the coefficient, the greater the disparity, and vice versa.

Using the formula, the Gini coefficients of this region's peasant income for the different years are as follows:

	1980	1981	1982	1983	1984	1985	1986
Gini Coefficient	0.2106	0.2067	0.1992	0.2518	0.2770	0.2877	0.2911

The table shows that income disparity increased significantly after 1982, when the villages fully implemented the production responsibility system, and individual household operations replaced collective operations. The income difference continued to grow in subsequent years. It increased 75 percent in 3 years and by 1986, the Gini coefficient reached 0.2911 and the disparity surpassed the national level.

4. Contrast between the "upper crust" and the "lower crust". If we echelon all peasant income from high to low, and take the top 20 percent of the population as the "upper crust" and the bottom 20 percent as the "lower crust," we can compare the upper and lower crusts by comparing an equal number of people with unequal income, and the degree of inequality can be accurately measured.

Comparison of Upper, Lower "Crusts"

Item	"Upper Crust", Percentage of Income	"Upper Crust", Net Income Per Capita (Yuan)	"Lower Crust", Percentage of Income	"Lower Crust", Net Income Per Capita (Yuan)	Income Ratio, "Upper Crust": "Lower Crust"
1980	32.65	327.79	12.48	125.27	2.62 times
1981	33.05	388.85	11.62	136.67	2.84 times
1982	31.29	444.45	10.99	156.13	2.85 times
1983	35.07	539.11	9.71	149.28	3.61 times
1984	37.81	685.98	9.46	171.75	4.00 times
1985	37.77	726.13	8.78	168.87	4.3 times
1986	38.04	798.27	8.38	175.96	4.54 times

The table clearly shows that the upper crust 20 percent of the population receives more than 30 percent of the income. Figuratively speaking, this is equivalent to one person receiving 1-1/2 to 2 persons' income. In the lower crust, it takes 1-1/2 to 2 persons to make up one average person's income, and by 1986 it took 2.39 persons to make up the equivalent of an average income. The income difference between the two groups grew increasingly bigger. In 1986 the gap widened to 622.31 yuan, or a 3.5 times the difference in income.

#### An Evaluation of the Disparities

So far we have described in detail the income disparities among the peasants in Xinjiang. There is no general consensus on how to evaluate the differences. The author thinks that the present disparities are quite appropriate and fairly reasonable.

1. The income dispersion is within "reasonable range," and the distribution of reward for work is basically rational. How do we define "reasonable range" quantitatively? The United Nations organizations, organizations in this country, and experts and scholars have adopted the following norm: if the Gini coefficient is below 0.2, income distribution is considered highly equitable. This situation is characterized by small income differentials; reward for work does not reflect amount of work; there is a lack of productive enthusiasm, and there is little increase in income. For Gini coefficients between 0.2 and 0.3, income distribution is relatively equitable. The associated characteristics are increase in income gap, basically rational distribution of reward for work, and rapid increase in production, accompanied by higher income. For Gini coefficients between 0.3 and 0.4, the distribution is fairly reasonable; the peasant's income more or less reflects his work, and production increases at the optimal rate; the living standard rises steadily. For Gini coefficients between 0.4 and 0.5 the differential is too high, and income is concentrated in the hands of a few. For the majority, enthusiasm is dampened. Where the Gini coefficient is above 0.5, the distribution of income is polarized, and income is extremely inequitable; production stalls. These authoritative delineations are valid in this region too.

During the past 7 years, where information can be obtained, the coefficients have remained between 0.2 and 0.3, except for 1982. The highest was 0.2911 which occurred in 1986. Based on the delineations described above, income is "relatively equitable". That means we are at a stage of increasing production and income and the distribution of income is almost, but not yet completely, reasonable.

Reality supports the above theory: during the past 5 years (1981-1986) production of food grains has increased 1.57 billion kilos, or 40.51 percent; cotton crop has increased 102.5 million kilos, or 90.22 percent; oil crops have increased 215.76 million kilos, which more than doubled previous crops; the GVAO rose by 2,037,000,000 yuan, or 60.21 percent; peasant income almost doubled. These growth rates are unprecedented, and they are attributable to the fairly reasonable income disparities in recent years.

2. A fairly ideal increase in income disparity well balanced by higher income. There is a close relationship between income dispersion and the overall level of income. In general, the latter determines the amount of income available for distribution, and the former determines the depth and width of the distribution. Ideally, at the early stage of economic development where income level is relatively low, it is desirable to see parallel increases in income and income disparities, that is, as income increases, income disparities should also increase because as the income gap widens it stimulates production which increases income. This in turn further whets the appetite of the producers, making them even more competitive. This kind of interaction and cycle produces good results.

In the past 5 years, peasant income in this region almost doubled, and the income gap more than doubled: the income gap is widening at a slightly faster rate than the rise in the income level. This means that in the past 5 years there has been an unprecedented increase in income, and this income is more or less evenly distributed among all peasant households. Thus income increase and income distribution are fairly well balanced.

3. Compared to the nation as a whole, the differential is fairly large, and the income gap is widening fairly rapidly, but they are compatible with conditions in the region. The following table is a comparison of the Gini coefficients for the past few years:

Item	1980	1981	1982	1983	1984	1985	1986
Nation-wide	0.2366	0.2388	0.2318	0.2450	0.2577	0.2635	-
Xinjiang	0.2106	0.2067	0.1993	0.2518	0.2770	0.2877	0.2911

The table shows that in the first 3 years, the Gini coefficients in Xinjiang are below the national level, but they are higher in the last 4 years. This is because, first, rural reform had a later start here than in the rest of the country; income gap quickly widened in 1983 after the reforms became a success. Second, relative to the rest of the country, this region has a small population; it has sharply contrasting natural conditions, and it has many minority nationalities which are very dissimilar. All these differences account for the wide income dispersion. Third, many people think that Xinjiang is a good place to make money, and indeed in recent years, the number of "10,000-yuan households" in rural Xinjiang has increased. But many also failed to earn a living every year. The proportion of people at the two extreme ends of the income scale are higher here than in most provinces and regions in the country. These three factors caused, and will continue to cause, a slightly greater income disparity in this region. But this "slightly greater" disparity is compatible with the natural economic conditions peculiar to this region. This region is not as well developed economically, as the rest of the nation. We sought, and will continue to seek, a higher rate of growth. Therefore greater disparities are desirable.

4. Lessons learned from other countries on increasing the income disparity. Adopting the Gini coefficient and integrating qualitative analyses to draw comparison among different countries and regions can help us gauge our own income dispersion and set a proper development trend.

The Gini coefficients worldwide reflect two general rules:

1. Poor countries have higher Gini coefficients than rich countries. For example, in Tanzania  $G = 0.5451$  (the Gini coefficient of different years are calculated for different countries), in Burma  $G = 0.5065$ , in India,  $G = 0.4878$ , in Kenya  $G = 0.6368$ , and in Sierra Leone  $G = 0.6117$ . In 1977 the highest per capita GNP among these countries was only \$460, but their Gini coefficients are relatively high; their income distribution is polarized. The Gini coefficients in rich nations are relatively low, for example, in Australia  $G = 0.3185$ , in Canada  $G =$

$0.3333$ , in Denmark  $G = 0.3673$ , in Japan  $G = 0.3106$ , in the U.S.  $G = 0.4171$ , in Holland  $G = 0.4493$ , in Norway  $G = 0.3622$ , and in Sweden  $G = 0.3872$ . In 1977 Japan had the lowest per capita GNP of \$6,510 among these countries, and their Gini coefficients range between 0.3 and 0.4.

2. The moderately developed countries, including those at a lower-than-average level of economic development, have the highest Gini coefficients; the underdeveloped nations have slightly lower coefficients, and the well-developed nations have the lowest coefficients. If we group the countries according to per capita GNP, the \$201-300 group has the highest coefficient, with  $G = 0.499$ ; next is the \$301-550 group with  $G = 0.494$ , then the \$101 to 200 group with  $G = 0.468$ , followed by the \$501-1000 group, with  $G = 0.438$ ; the group with under \$100 has  $G = 0.419$ , the \$1001 to 2000 group has  $G = 0.401$ , and the \$2000 and above group has  $G = 0.365$ .

Except for China, Korea, and a few other countries, all nations rich or poor have Gini coefficients above 0.3; most are above 0.4, and 1/4 are above 0.5; a few countries have coefficients higher than 0.6.

These worldwide observations signify the following: developing countries, in order to increase productions to make the nation and the people richer, have greater income disparities. When a country is prosperous and strong, the difference narrows. This may be a general law which makes no distinctions as to national boundaries or class.

This law naturally applies to this region. Xinjiang is a developing region. During its development there should be some increase in income disparity. For this point, the 0.3 Gini coefficient is too low, but overall, it is normal and fairly reasonable. Granted this fact, there are other inequities, mainly, income disparities between the north and south, and between agriculture and animal husbandry. These disparities, to a large extent, are attributable to geographic and physical factors (naturally, we cannot rule out the workers themselves as a factor.)

### Controlling the Disparities

By "control" we do not mean narrowing the income gap, but rather we are talking about controlling how much income should differ, and how fast the income gap should widen.

Because of normal changes in income, and because of conditions native to Xinjiang, I feel that the general principle in controlling income disparity is to continue to use administrative and economic measures to further widen the income gap among peasants and maintain a planned and rational rate of increase in the differences while striving to keep them within "optimal range" so as to stimulate enthusiasm. In order to realize this goal, the following measures should be adopted:

1. Substitute "controlled disparity" for "random disparity". The present rural income disparity in this region, as well as throughout the country, is the result of random developments; it is an "unregulated disparity." This means the income gap widens, narrows, or remains unchanged not because of actions taken by the decision-makers purposefully and intentionally. Instead it is a random change due to nonuniform changes in the income of the peasant households. If the policymakers can intervene directly in certain important issues, such disparity can and should be controlled. Making use of appropriate differences is an important means to promote production and higher income. Relevant government departments should put this task on their agenda and regularly recruit experts to study this issue carefully. They should define a fairly realistic range of dispersion and set a goal limiting the range for each year, based on the year's production and income increases, and instead of making tardy adjustments, try to take early control full advantage of the disparities.

2. Maintain the policy of allowing some people to prosper first. This guarantees greater income disparity. We have clear and proven results from the past 5 years, and in the future, we should maintain this course, especially in regions which are still relatively poor. We should deliberately allow a portion of the people to prosper and support and nurture the specialized households, the priority households, and the science and technology prototype households in the villages so they can act as catalysts and role-models.

3. Maintain a reasonable speed in widening the income gap. First, the overall income at present is low; there is little money to distribute, or to augment the income gap. Second, widespread poverty still exists, and this requires part of our energy, because we must solve the poverty problem first. Three, at present, product prices, regional price disparity, including policies, administration and management, need to be improved. There are big loopholes, especially in product prices, and many people easily take advantage of these loopholes, and engage in speculation and profiteering. Because of these three factors, if the income gap widens too quickly, the result will be undesirable, but if the gap is too small, it will be an ineffective stimulant. During the "Seventh 5-Year plan," the Gini coefficient should be limited to no more than 0.01 point increase each year.

4. Exercise administrative intervention, and make economic adjustments against certain trades and some peasants who are earning an exorbitant income, to prevent the over concentration of wealth in the hands of a few people. At present, there are several very wealthy "10,000-yuan" or "100,000-yuan" households in the villages in this region. Some of them no doubt obtained their wealth through hard work, but there are individuals who obtained their wealth by evil means, by speculation and profiteering, and they must be seriously dealt with. Although we cannot find fault with those who became "10,000-yuan households" through hard work, under the

present circumstances where total income and overall living standard are low, great individual wealth can cause overall policy problems, and therefore should be suitably limited.

12986

#### Analysis of Ecotypes of Wild Soybean (*G. Soja*) in China

40110011 Beijing ZHONGGUO NONGYE KEXUE  
[SCIENTIA AGRICULTURA SINICA] in Chinese  
No 5, 1987 pp 29-35

[English abstract of article by Xu Bao [1776 6283], et al., of the Soybean Institute, Jilin Academy of Agricultural Sciences, Gongzhuling, Jilin]

[Text] In 1981-1985, the photo-thermo effects on the development of wild soybean (*G. soja* Sieb. et Zucc.) under four photoperiods (8, 12, 13.5, natural day length at Gongzhuling) and five day/night temperature regimes (35/25, 30/20, 30/10, 20/20, 20/10°C) were analyzed. The developmental and morphological characteristics of 292 accessions (under 13.5 hr) from various regions in China (24-52°N, 98-135°E, 0-2650 M) were also analyzed. It was found that:

1. All materials were short-day plants. The correlation between sensitivity to day length and latitude where the plant originated coincided with the exponential curve.

2. Days from emergence to flowering of most wild soybeans were longer under 35/25°C than those under 30/20°C. For the thermo-effect, the 35-40°N region was a critical area—north of it, the materials exhibited wide suitability to both low and high temperatures, while south of it, narrow suitability only was shown.

3. Under different photoperiods, the thermo-effects of low latitudinal wild soybeans could be opposite, with some accelerated and some experiencing delayed flowering.

4. Under certain definite photoperiods and temperatures, some high latitudinal materials exhibited "abnormal pods" and some low latitudinal ones delayed podding.

5. The geographical regions of the photo-thermo-ecotypes of wild soybeans in China were classified. The relationship between the growing period and the photo-thermo-ecotypes, and the problem of the wild soybean as a non-air temperature-zone species are discussed.

9717/9604

**Marshallagia Grossospiculum N. Sp.—New Trichostrongylid Nematode From Sheep**  
40110009 Tianjin XUMU SHOUYI XUEBAO [ACTA VETERINARIA ET ZOOTECHNICA SINICA] in Chinese No 4, Nov 87 pp 273-276

[English abstract of article by Li Conglin [2621 0654 2651], et al., of the College of Veterinary Medicine, Beijing Agricultural University]

[Text] In 1983, a batch specimen of trichostrongylid nematodes from sheep in Gansu Province was collected. Among the male worms of Marshallagia, many *M. mongolica* and about 30 of another species were found. The Marshallagia females were collected and their eggs were cultured to raise infective larvae. About 500 infective larvae were obtained, and a yearling worm-free sheep was infected in Beijing. About 35 days post infection, the sheep began to deposit eggs from the feces. The sheep was killed and necropsied 55 days after infection, and 38 specimens of Marshallagia were collected from the abomasum. Among these nematodes, there were 12 *M. mongolica* males and only one male belonging to the new species.

*Marshallagia grossospiculum* n. sp.: 21 males, 12-6.8 mm in length and 0.15-0.225 mm in breadth, length of esophagus 0.625-1.04 mm, distance from deirids to anterior end 0.38-0.5 mm, distance from excretory pore to anterior end 0.35-0.44 mm. The nerve ring is situated 0.035-0.1 mm anterior to the excretory pore. The dorsal ray of bursa is long, 0.215-0.315 mm in length, and splits at its posterior third. Each limb gives off a short lateral branch at its posterior fourth, and each limb ends in two small twigs. The spicules are dark brown, relatively robust and 0.29-0.35 mm in length and 0.037-0.05 mm in breadth. Each ends in three branches. The outer branch is about 0.12-0.177 mm in length, and its distal end bends to the middle like a teaspoon. The inner branch is somewhat like a club, and 0.075-0.12 mm in length. The dorsal branch is thick and 0.09-0.145 mm in length. Its distal end looks very strong, like a ploughshare. Gubernaculum is absent.

Females: None has yet been identified.

Specimens deposited: Holotype, male, BAUV Helm Coll No 485001; paratypes male, BAUV Helm Coll No 485002.

9717/9604

### SDI Problems, Viable Alternatives Discussed

40050057a Beijing JIEFANGJUN BAO in Chinese  
23 Oct 87 p 3

[Article by Cai Wenyi [5591 2429 6318]: "Alternatives in the Space Race"]

[Text] Opinions Vary on the Strategic Commanding Points

Ever since America announced its "Strategic Defense Initiative [SDI]" (the "Star Wars" plan), the competition in space between the United States and the Soviet Union, which has existed for a long time, has been covered with a tint of military theory. Some people call it the "space strategy." In some developed countries there has been an upsurge in the development of high technology with long-range plans for scrambling for the commanding points in the space strategy.

Along with the heightened interest in space strategy, in China and abroad people with different opinions have made them known and their views vary widely. Some people, viewing it from the angle of war and peace, think that once the U.S. "Strategic Defense System" is successfully deployed before the Soviet Union deploys theirs, the threat of nuclear war will be intensified. Some people, viewing it from the angle of S&T and economic development, think that whoever takes the lead in the high tech field connected with "Star Wars" will be in the forefront of world economic development. Some people, analyzing it from the military angle, think that space technology is the "deterrent force of deterrent forces" and that space strategy will replace nuclear strategy. They also think that by the end of this century the growth or decline of the nuclear deterrent forces of medium-sized nuclear countries will depend on the degree of their development of space technology, and that if they cannot get a foothold in space they will be dominated by others. Thus they conclude that the developing countries should grasp the opportunity to "catch up."

Facing this "space tide" raised by the superpowers, the medium-sized nuclear countries, particularly the developing countries that have a limited number of nuclear weapons, consider: As we are drawn into this tide together with the developed countries, should we expend a lot of strength to "catch up" or, proceeding from the situation in one's own country, seek another way of formulating our own strategy? This is truly a major question about which the advantages and disadvantages, the gains and losses, need to be carefully weighed.

### The Meaning of "Despot" Is Not Abstruse

What is the essence of the space strategy? What is the purpose of the space strategies put forward by the superpowers? These are questions that must be clarified before the developing countries make their strategic decisions.

For the United States there were two main objectives behind its putting forward of its space strategy: First, in the present state of affairs in which nuclear deterrence means "mutually assured destruction" its "strategic defense system" will cause the Soviet nuclear deterrent to lose its efficacy, and thus America's own nuclear deterrent will retain its efficacy. Second, the development of the high technology centered on "Star Wars" will promote America's S&T development and its economic recovery; at the same time the Soviet Union, depleting its national strength in the space race, will slow its economic development and be bled white. The United States' general objective is still to contend for world supremacy.

Thus it can be seen that the purpose of putting forward the "space strategy" was not to replace, but rather to enhance, the nuclear strategy. It is a new way of maintaining the nuclear deterrent, and it is an extension of the nuclear strategy.

The reason some medium-sized nuclear countries are taking part in the space race is also to maintain the effectiveness of their own limited nuclear deterrent and their positions as great nations. As for certain nonnuclear developed countries that are keen on studying and developing space technology, their purpose is to make advances and become politically powerful nations, and their motive is to join the nuclear club.

All this shows that although all the powers are now contending with each other in the race to control the strategic commanding points in space, their military objective is to maintain the efficacy of their own nuclear deterrent and to cause, as much as possible, the other side to lose the efficacy of its nuclear deterrent. Generally speaking, the purpose of "controlling the commanding points" is to "control the nuclear balance."

### It Is Not Necessarily Wise To Join in the Pursuit

Developing countries that possess a limited number of nuclear weapons want to seize a foothold in the space race, and they have only two objectives in this respect: 1) to maintain the efficacy of their own limited nuclear counterforce; and 2) to spur the development of high technology and to promote S&T and economic development.

With regard to the second objective, it is highly necessary to invest a certain amount of manpower and material resources in tracking certain high technologies in order not to widen the gap with the developed countries during the new technological revolution and in order to promote the development of one's own national economy.

With regard to the first objective, it is necessary to make an earnest analysis of how much bigger a price must be paid as well as whether one can catch up with the other "team" at the present time.

First of all, there must be adequate financial backing for the space race. According to one estimate, SDI will cost \$1 trillion. Even if that figure were to be cut by nine-tenths, no developing country could bear this burden. Making an enormous financial investment in the space race would certainly affect the speed of a country's economic development and fundamentally weaken its national defense potential.

Next, some of the newly emerging disciplines in high technology are not "rootless trees," but were developed on the basis of old disciplines and traditional industries. Space technology is not an isolated high technology, but rather is a combination of traditional industrial technology and high technology. Without a solid foundation in traditional industrial technology, without the powerful support and cooperation of traditional industries, even if high technologies can be achieved in the laboratory, it will be difficult to swiftly transform them into space operational capability. The idea that a new discipline is merely something new for a given country, and that the developing countries can at similar speeds make breakthroughs in high technologies and transform them into actual combat capability, is mistaken.

Today, when military technologies are developing at high speed, it is very possible that the one who blindly pursues someone else will always be one or several steps behind. From first to last he will fall behind the other party, the gap between them will even become wider, and he will be unable to extricate himself from the passive situation of being controlled by the other party.

### The Space Strategy Is Not Flawless

Once one of the superpowers attains superiority in the space race, does that mean that it can become "emperor of the world"? Is contending for the commanding points in space the only way for the developing countries to maintain the efficacy of their limited nuclear counterforce? This writer thinks that the role of the space strategy should be adequately estimated, but not estimated too high. It has its own intrinsic weaknesses. For the developing countries, this is not the only path to take to maintain the efficacy of their own limited nuclear counterforce.

At the present time, no matter whether it is the means of delivery of the United States and the Soviet Union or the means of delivery of the medium-sized nuclear countries, the main means of delivery is the intercontinental ballistic missile [ICBM]. The so-called "Strategic Defense System" was designed with the ICBM in mind. In the interception operation plans that have been designed, no matter whether it is the 4-stage, 3-level interception plan or the 4-stage, 7-level interception plan, the spatial positions of the interception at all levels are in the upper air and space. Some military commentators employ the vivid metaphor of "rainproof roof" to

describe America's "Strategic Defense System," meaning a special defense against ICBMs coming in from space. Therefore, the system is basically helpless against a means of delivery coming in from a low altitude.

Although a roof can keep off the rain, without walls it is difficult to block the wind. Why couldn't medium-sized nuclear countries and developing countries make use of the weakness of the "Strategic Defense System" with regard to the "wind" to stay clear of the enemy's main force and strike at his weak point?!

### Finding a New Path by Taking the Circumference for a Straight Line

Actually, the common people long ago clearly understood the defect of the "Strategic Defense System." At the same time that the United States and the Soviet Union are developing space weapons on a grand scale, they are, without disclosing the fact, stepping up the development of long-range cruise missiles and anti-cruise missile defense systems. One of the reasons is that a cruise missile is able to slip through the gaps in the "Strategic Defense System."

First, on a long-range raid a cruise missile will not go into the upper air but rather will fly at a low altitude all the way. This puts the "roof" in a helpless position. Second, a cruise missile is small in bulk and, with the addition of stealth technology, it is very difficult for radar to discover it. When it breaks through defenses at minimum altitude it is extremely difficult to intercept. Third, compared with an ICBM it is small in body and light in weight. Thus it can not only be launched from the ground but also carried on board aircraft, ships, and submarines. "A wily hare has four burrows"—a crafty person has more than one hideout. Thus it has better survivability. Fourth, its range is long (3,000 kilometers now, and an invisible cruise missile with a 10,000-kilometer range is under development). It is highly accurate (its circular probability of error is only several dozen meters). It can carry both nuclear and conventional warheads. It has a dual nature in which the strategic and the conventional form an organic whole. Fifth, defending against cruise missiles is very difficult. The expenses for "building a wall" against them are enormous, and one would need to deploy a large number of early-warning aircraft and also interceptors with look-down and shoot-down capability, air-to-air missiles, and surface-to-air missiles charges with the terminal defense of important targets. Comparing the consumption and expenditure on attack and defense, some estimates abroad put the ratio at 1:5; other estimates are 1:13-15. Finally, the cost of the entire service life of a cruise missile is lower than that of an ICBM, and the technical difficulties involved are not as great as those of "Star Wars." Many of the technologies used for it can be applied in the development of civil aviation. Relatively speaking, it is a suitable means for expanding the limited nuclear deterrent that the developing countries have without losing alternatives.

The above analysis shows: The developing countries must be extremely careful with regard to the "space strategy." They must mull it over again and again and must not jump into it rashly. Under the circumstances in which a big war will not break out for some time, our attention should be concentrated on economic construction and on the development and accumulation of national defense potential. When employing a certain number of forces to track high technology, the developing countries should try to find a way to keep their limited nuclear deterrent and to enhance the benefits of national defense strength.

"There are a thousand paths to climb the mountain, from the top of which we will put a rope around the high moon." There are many ways to seize the strategic initiative. As for what path to take to do so, one must proceed from the specific circumstances of one's own country.

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**Efforts To Nurture Combined Arms Mentality**  
40050056a Beijing JIEFANGJUN BAO in Chinese  
18 Oct 87 p 1

[Article by staff reporter Jiang Yonghong [3068 3057 4767]: "Combined Arms Style Pervades the Barracks"]

[Text] Review of Reform in Armed Forces Work

**Seen Through the Mirror of War**

In 1979, during the course of the war of self-defensive counterattack against Vietnam, two strange affairs occurred:

When giving the order to move out, a division commander forgot his artillery regiment. When the troops arrived at their new assembly area, it was discovered that the "god of war" had been left behind.

A company commander ordered an attack on a certain height, and he personally led the assault. The company attacked the position for a long time but it did not fall. The higher level asked him: What have you done with the artillery, engineer, and chemical defense troops that were attached to your command? He clapped his head, "Oh, I forgot about them! I forgot about them!"

In these two strange affairs there is one common problem: the minds of a considerable number of commanders lack the idea of combined arms operations—this "key note."

War is the mirror of training. The war of self-defensive counterattack against Vietnam in 1979—this small mirror—reflected the state of the PLA's training at that time. The results of the test of actual combat shouted: Combine arms! Combine arms! Combine arms!

**After Casting One's Gaze on the World**

The 3d Plenary Session of the 11th CPC Central Committee opened the gateway to China, and it also drew the gaze of militarymen from the walls of the barracks out toward the world.

In the United States of America, every year the Joint Chiefs of Staff must direct and coordinate 60 to 80 training exercises in which the service arms are combined.

In the Soviet Union, each Army division of the Soviet Armed Forces must conduct one combined arms exercise a year. The combined exercises conducted by the Army, Air Force, and Navy, which are directed and coordinated by the General Staff and the military districts, are not inferior to those of America.

What about the PLA's training? There once existed to varying degrees the problem of emphasizing infantry and deemphasizing specialists, emphasizing techniques and deemphasizing tactics, and emphasizing fighters and deemphasizing cadres. In a word, in training there was a lack of the consciousness of combined arms, and the training went back and forth in a circle of the individual soldier and the single service arm.

Following the development of military science and technology and the evolution of the forms of warfare, war long ago stopped being a duel between individual soldiers and became a trial of strength between combined forces. Of course a combined force cannot be separated from the high quality of the individual soldier and the unit, but what is more important is the scientific and rational structure of the armed forces and the coordination in unison of the operations of all branches and arms of the service.

As early as the time when the War of Resistance Against Japan changed to the War of Liberation, General Liu Bochong, during intervals in the war, translated the Soviet book "Combined Arms Tactics," a book that played a very large guiding role in the War of Liberation. However, the PLA's tradition was basically the infantry tradition, a fact that causes the idea of a single service arm to "rule" the minds of a considerable number of commanders.

If we want combined arms we must challenge certain outmoded old habits and get out of the rut of a single service arm. Since 1979 the PLA has, from top to bottom, done research on foreign armed forces, and this academic research has emancipated the mind in the military domain. It has awakened a generation of military men who had been wallowing the PLA's glorious history: We are backward, our weapons and equipment are backward, and what is even more frightening is that our military thinking and training ideas are backward!



For a glorious armed force to be conscious of its own backwardness is a great step forward. It is precisely this sense of urgency that will make commanders at all levels break out of the rut of a single service arm and cross over to the new flight of steps that is combined arms training. The Army-Air Force combined arms campaign exercise that was staged at a certain place in North China in September 1981 was the first display of the results of the PLA's combined arms training after the "Cultural Revolution," and it was commanded by Military Commission Chairman Deng. "Be geared to modernization, be geared to the world, and be geared to the future" is not only the guiding policy in the education of military colleges and schools but also the guiding policy in the training of units.

### **Signs of the Improved Level of Combined Arms**

The work written by the three PLA general departments entitled "On Some Problems in the Reform of the PLA's Education and Training," which was printed and distributed by the Central Military Commission in January 1984, formally put forward the proposition that education and training must be focused on cadres and on combined arms. Since then there has been a rapid improvement in making combined arms universal.

One of the signs of the improved level of combined arms is that a new training outline has been issued and put into force. This outline is the concentrated embodiment of the guiding ideology for training. In the past the training outlines for the arms of the Army formed their own system from the individual soldier to the regiment. Because of the different times that each arm completed basic training, it was impossible to bring them together in the tactical training stage. Now the basic training topics have been reformed, duplicative topics merged, outmoded topics streamlined, and basic training times shortened. The synchronous entry by all arms into the joint training stage has been insured. The establishment of training divisions and regiments has made possible the separate training of recruits and veterans. To implement the new outline, after the General Staff Department held a demonstration meeting in 1985 on the reform of the training content for infantry fendui, it held in 1986 an on-the-spot meeting on the reform of combined arms tactical training. This year it held another on-the-spot meeting on the reform of tactical training. Thus a completely integrated new training system for Army divisions has been formed, putting combined arms training on the track of regularization.

The formation of combined arms group armies was another sign of the improved level of combined arms in the PLA. In the past the leading groups of the Army's armies and divisions seemed to be composed of "one color," namely, infantry cadres, but during the reorganization there was an allocation of "combined arms groups." Following the gradual perfecting of the training system in military colleges and schools, more than 70 percent of the commanders at the two levels of army and

division have received regular training in middle- and high-level command colleges and schools. In addition, there is the form of training in which each unit regularly runs concentrated training classes and study classes on campaign operations. All of these things have greatly improved the quality of command over a combined arms army exercise by the senior officers and leadership organizations. This is another important sign of the raising of the level of combined arms in the PLA.

The development of laser and electronic simulation equipment, and the two-sided tactical exercises with such equipment conducted by the Army, Navy, and Air Force, have provided a means of conducting live two-sided training that saves money, is lifelike, is safe, and is highly efficient. Laser and electronic simulation equipment provides a means of improving the PLA's combined arms training, and is also a sign of new developments in this training.

Recently the General Staff Department and all large military regions made a comprehensive examination of some Army divisions that had been comprehensively trained. The divisions and regiments that took the examination scored an average mark of over 90 in combined arms training. Isn't this more cause for joy than the appearance of many crack marksmen and crack gunners?

### **Constant Progression From Low Grade to High Grade**

Combined arms training is a process of constant progression from low grade to high grade. How can the PLA's combined arms training make the progression to the high grade? Some commanders once thought highly of large-scale combined arms exercises by the three armed services, but did not think much of combined arms training on the division or reinforced regiment scales. Now, although the armed forces of the United States, the Soviet Union, and the developed countries of Europe still take seriously large-scale combined arms exercises, the focus of their training is on combined arms at the division and brigade levels. This may be said to be a trend in current combined arms training. This trend is in line with the development of preparedness against war toward higher levels and emphasis on quality and with the development of armed forces groupings toward miniaturization.

Therefore, we should put the focus of combined arms training on the composition of basic combined arms units. In a certain sense, the composition of combined arms armies, divisions, and brigades, as compared with the composition of large army groups, requires more precision, meticulousness, and coordination. Thus it is more difficult. From a look at the present situation in the PLA's training, we see that within the armed services there is a lot of combined arms training by the service arms and little combined arms training that cuts across the lines between the armed services. All of these things await further progress and enhancement.

In addition, some commanders, once the subject of combined arms training is brought up, sigh about the backwardness of our weapons and equipment. They think that to depend on existing equipment is like the case of a monkey who climbs to the top of a tree and can go no higher. Admittedly, advanced weapons and equipment are an important condition for raising the level of combined arms. However, advanced military thinking can make inferior weapons and equipment produce maximum results. Conversely, backward military thinking can sharply reduce or even make come to nothing the superiority of weapons and equipment. Military confrontation in a period of peace is not only a contest in weapons and equipment but also a competition in military thinking. Therefore, in combined arms training not only must there be training with weapons; what is more important is that there be training in command and military thinking. Combined arms training must be based both on existing equipment and on a little more advanced mentality and on some advanced training within its power. Dominance on the battlefield of the future belongs to those who possess this advanced mentality in the period of peace and to high-ranking military officers who have made advance preparations in training. History has already proved this proposition many times.

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**Mao's Military Education Ideology Assessed**  
40050056c Beijing JIEFANGJUN BAO in Chinese  
6 Nov 87 p 3

[Article in the "Academic Trends" column: "Article Written by Jinan Military Region Deputy Commander Gu Hui Discusses the Main Content of Mao Zedong's Military Education Ideology"]

[Text] Gu Hui [0942 6540], deputy commander of the Jinan Military Region, in his treatise entitled "A Preliminary Exploration of Mao Zedong's Military Education Ideology," systematically explored the main content of this ideology.

Gu Hui maintained that the main content could be roughly divided into five aspects: 1) The idea of "learning about war from war." This idea has three levels of meaning: "study for the purpose of application, stressing that military education has a clear objective, that study is for the purpose of application, and that military men should be trained for the war that they will probably fight; "study while applying," that is, learn directly from practice and give prominence to the direct nature of military education; and "train during intervals in operations for double effect," thereby making combat and training compatible. 2) The idea of regularized education. Comrade Mao Zedong always advocated the regularized training of the armed forces. He set the basic goal of training, by means of regularized education, as that of

training the cadres and fighters in organization, planning, accuracy, and discipline. He also made the fundamental demand for this education, namely, the unity of the leadership, rules and regulations, system, discipline, and orders. 3) The idea of paying much attention to the training of cadres. Comrade Mao Zedong attached particular importance to cadre training. As early as the period of the initial formation of the Red Army, he founded in Jinggangshan our army's first training unit. From that time on he attached importance to building up the army as both a fighting force and a school. 4) The idea of giving equal weight to military and political training. In this idea are three layers of meaning: the objective of all military education is both to train a large number of military talents and to keep in mind the overall improvement of the units' combat effectiveness; with regard to the specific objects of military education, attention must be paid to the cultivation of their political quality and to the improvement of their military quality, thereby achieving the dialectical unity of making them both Red and expert; and with regard to the content of military education, both military and political knowledge must be instilled. 5) The idea of having democracy in military education. This idea includes: military education must be made universal and must encourage the officers and men to help each other in their studies, so that their knowledge is blended. The education must depend on the initiative of the vast number of officers and men, and "blind angles" in military education must be eliminated. Military education must be competitive, so that the vast number of officers and men catch up with and overtake each other during training. In addition, Comrade Mao Zedong's military education ideology was full of the nature of all the people.

The article also said that, in tracking the historical orbit of the PLA's military education, Mao Zedong and the other proletarian revolutionaries of the older generation, in the major practical activities of military education in every historical period, made a series of brilliant expositions on military education. These expositions reflected the formation and course of development of Mao Zedong's military education ideology. They played a directional and promotional role in the practice of the PLA's military education. That the PLA has gone from being small to being large, from being weak to being strong, and has developed into a people's armed force that today is at a certain level of modernization, cannot be separated from Mao Zedong's military education ideology. Today, the enhancement of the study of Mao Zedong's military education ideology, no matter whether it enriches and develops this ideology or solves new problems in the PLA connected with the practice of military education, is of important significance. In conclusion the article makes a specific exposition of the main aspects in which Comrade Deng Xiaoping has enriched and developed Mao Zedong's military education ideology.

9727

**Shenyang Commander on Militia, Reserve Building**

40050059 Shenyang DONGBEI MINBING  
[NORTHEAST MILITIA] in Chinese  
No 9, 4 Sep 87 p 1

[Article by Liu Jingsong [0491 4737 2646], commander of the Shenyang Military Region: "Continue To Enhance the 'Four Concepts,' Do Good Militia and Reserve Work"]

[Text] After the 3d Plenary Session of the 11th CPC Central Committee, the focus of all the party's work was shifted to making economic construction the centerpiece, and the pursuit of the socialist four modernizations became the overall situation in China. This new situation imposed new demands on militia and reserve work. Here I will discuss four views on how to better meet this new situation and do good militia and reserve work.

**Enhance the concept that "a strong military requires a wealthy country," and vigorously organize militia and reserve personnel to take part in building the two civilizations.** In the people's armed forces system, the idea of centering on state economic construction—this overall situation—in strengthening the building of national defense reserve forces has been basically established. People's armed forces departments and reserve units at all levels, under the guidance of this correct idea, have done a lot of work, for which they have been praised by the local leadership. This fact should, first of all, be affirmed. However, one should also see that, in accordance with the demands imposed by the party Central Committee and the Military Commission, we, in thoroughly implementing the guiding ideology on building national defense reserve forces, still need to do a lot of work. There are some problems, particularly in the leaders' ideological understanding and in organizational guidance, that urgently require solution. Economic construction is the foundation of national defense construction, and only if the country is wealthy can the military be strong. If economic construction moves forward and there is a solid financial and material foundation, we can fundamentally increase our national defense strength. We certainly must stand on the height of the overall situation, correctly understand the strategic change in the guiding ideology for national defense construction, establish the idea of consciously subordinating ourselves to and serving the overall situation, base ourselves on the correct points, have our feet planted on solid ground to implement things well, and widely organize and arouse the militia and reserve personnel to make more contributions to the overall situation in economic construction. This is the unshirkable responsibility of our people's armed forces departments and reserve units.

**Enhance the concept of "being vigilant in peacetime" and conscientiously improve the capability to deal with regional conflicts and sudden incidents.** In the more than 40 years since the end of World War II, a world war has

not broken out. But regional conflicts have never stopped. Looking at the strategic situation in the contemporary world, we see that the Soviet Union and America, in contending for world hegemony, are still intensifying the arms race and contending for spheres of influence. As long as hegemonism exists, we absolutely cannot relax our vigilance against the danger of war. Therefore, we must be vigilant in peacetime, not forget about preparedness against war while we build, maintain a high degree of alertness, and conscientiously enhance preparations for dealing with regional conflicts and sudden incidents. In making good preparations for dealing with regional conflicts and sudden incidents, there are many things that must be done in militia and reserve work, but there are two things that must be made the key points and really grasped well. The first thing is to strengthen militia work in the land and sea border defense areas in order to deal with any contingency; and the second thing is to build the reserve units well. Reserve units are the important form of organization for effecting rapid mobilization in wartime. At all levels we must concentrate efforts on consciously building reserve units well so that they are able to become an emergency operational force worthy of the name.

**Enhance the concept of "long-term construction" and in a down-to-earth way lay a good foundation for wartime mobilization.** Now and for a period of time in the future the basic policy of militia and reserve work will be "reduce quantity, improve quality, grasp key points, and lay a good foundation." The point about "laying a good foundation" in this policy in essence is the strategic change in the guiding ideology for national defense construction. Thus the center of building reserve forces has shifted from a brink-of-war state based on the idea of fighting soon to the long-term requirements of national defense construction. This entails a switch to overall construction with modernization as the center, so as to build a national defense reserve force of high quality that is suited to the armed forces' modernization in order to win victory in a future war and truly do good preparatory work for militia mobilization.

**Enhance the concept of "reforming and blazing new trails" and constantly bring about new situations in militia and reserve work that are full of vitality and vigor.** Following the deepgoing launching of the reform of the state's economic and political systems, new and higher demands will be imposed on our reform of militia and reserve work. For our leading comrades at all levels to take the lead in enhancing their own consciousness of reform, I think they should at least make an effort in the following three aspects. First, they must conscientiously study the relevant documents of the party Central Committee and the Military Commission, and become interested in and understand the total situation in the development of local reforms, so that the reform of militia and reserve work is carried out in synchronization with the pertinent local reforms. Second, they must handle well the relationship between carrying on traditions and blazing new trails. In the new situation we must continue

to carry on the fine traditions of militia and reserve work. However, the parts and the forms and methods in the traditions that practice has proved to be unsuitable to the requirements of the development of the new situation must be drastically reformed. Third, they must, while making an effort to study the art of modern leadership and to draw on new scientific knowledge, continue to insist on getting deeply involved in investigation and study, and proceed to the next step of improving the scientific nature and the effectiveness of the reforms.

9727

**Allowing Selected Units To Modernize First**  
40050057b Beijing JIEFANGJUN BAO in Chinese  
6 Nov 87 p 3

[Article by He Chong [0149 5039]: "Let Some Units Modernize First"]

[Text] China needs armed forces that are at a fairly high level of modernization. This has been the loudest cry from contemporary military men, and it is an objective demand for modern military confrontation. What path should the PLA's modernization take? This writer thinks that there should be a planned, focused echelon deployment in which some units are allowed to modernize first.

There are specific characteristics in the development and evolution of anything. The world's military powers have abundant financial resources. Under the stimulus of the arms race, the focus of their development has been put on the seabed and space. The PLA needs to be modernized under the overall situation in state economic construction; there are few funds for the modernization and the foundation for it is poor. This necessitates finding a pattern of modernization in which less money is spent and higher efficiency is achieved, so that a path is taken that suits China's national condition and its military modernization. This means that there must be a division into levels and steps that lets some units become modernized first.

Historically, China has always been a country with a strong small-scale peasant economy, and the influence of the mentality of egalitarianism is extremely strong. In the economic restructuring today, considerable force is needed to break away from the "one big pot" and overcome egalitarianism, so as to cause vigorous competition between enterprises. As a corollary, in our national defense construction, under the circumstances in which funds for it are limited, if we cannot "make a fist" and look at the key points, not distinguishing the primary from the secondary, using financial resources on an average basis, and having everybody modernize together, this in reality would mean that nobody would either modernize or "fly." Conversely, if we adopt the tactic of dividing things into steps and modernizing one part after another, first concentrating material and financial resources on modernizing "ace units" and "fist units,"

then we will be able to do some good things. Now, when the topic of national defense modernization is brought up, everybody feels that it is important but also shakes his head and sighs that there is no money for it. This is because, after counting on his fingers, everybody feels that the financial resources are insufficient.

In fighting a war, one's forces must be concentrated so that the few can defeat the many. To modernize one should also concentrate one's financial and material resources to make a given point the first target of attack. If there is no focus there will be no method. This is true if there is a lot of money, and it is even more true if there is little money. Grasping the key points, building key points well, developing important projects, and, under an overall plan, spacing out the gradients, forming an echelon deployment, unifying thinking and understanding, concentrating limited financial resources, arousing the enthusiasm of all quarters, letting some units modernize first, building them up one by one, shifting the direction of investment to them one by one, and gradually effecting the transition from "individual transformation" to "total transformation"—this perhaps is the specific path that the PLA's modernization should take.

When a snowball is moving in snow, the more it rolls the bigger it gets; letting some units modernize first will produce a "snowball effect." If some "individuals" are modernized first in a planned manner, their number will grow, a qualitative change will be produced, and a quantitative change will become a qualitative change, thereby accelerating the process of armed forces modernization.

Conversely, an excessive stress on "modernization of all in unison," a blind "scattering of pepper everywhere," an attack on all fronts, and an equal push along one line can only result in more haste but less speed.

There are many advantages in letting some units modernize first, and at least the following ones may be cited: First, it tallies with the objective demands imposed by regional conflicts. By having a part modernize first, the demands of regional conflicts are met. Second, it fully arouses the enthusiasm of the units that are modernizing for taking the initiative in coordinating with other units, and it adds more vigor to modernization. Third, it clearly points out to the units that will be modernized later the direction of advance, and opposite side of the other units' experiences plays an even greater guiding role. Fourth, it cuts unnecessary waste, increases the rate of investment to result, and is convenient for concentrating financial and material resources to gradually solve problems of their dispersion that were previously unable to be solved, thereby forming a good cycle. Thus there is an organic unity and combination of the view of value and the view of result.

The practice of some units has given answers in this respect. After the strategic change in the guiding ideology for building the PLA was made, in certain military

regions the training cost did not increase but on the contrary decreased. Moreover, in the military regions there was a quickening of the pace of the modernization of training. What was the reason for this? This writer once interviewed the responsible comrade of the military training department in this military region, and we jointly explored this question.

Writer: I hear that over the past 2 years our military region has made a breakthrough in the modernization of training and that the training is full of vitality and vigor. Do you know the reasons for this?

Military Training Department Director: The main reasons may be summed up in this key point: "letting some units modernize first." Since the beginning of 1986 the military region has obtained successes in conducting experiments at the selected points of one division and two regiments in the reform of training methods. In 1986 we cut some unnecessary expenses and concentrated our financial resources on supporting key units. Today, one year later, there is a big change in the training methods at these experimental-point units. The PLA General Headquarters recently popularized our experiences.

Writer: Can you be a little more specific?

Military Training Department Director: Take, for example, a certain training division. In the past its training facilities were all simple and crude. Over the past 2 years, the military region has concentrated, in relative terms, some financial resources on this division, and in a short time its appearance has changed. Now the division basically meets the demands that training sites be system-built, that training equipment be of the simulation type, that audio-visual training be serialized, and that management methods be made scientific.

Writer: Didn't the pooling of resources to let some units modernize first have a bad effect on the building of other units?

Military Training Department Director: No. There is a common saying: "If a pair of chopsticks is added when there are many people at a feast, and if every 10 persons saves a bite, the one who got the chopsticks will get fat." Taking a little off the top of each unit does not affect it greatly, but the little sums add up to a considerable figure for the unit being modernized.

Look, letting some units modernize first is feasible. As for whether it is a shortcut in the march toward the goal of national defense modernization, that is a question that awaits everybody's joint exploration.

### Shenyang Group Army Counter-Invasion Capability

40050056b Beijing JIEFANGJUN BAO in Chinese  
14 Oct 87 p 1

[Article by Zhang Binsheng [1728 1755 3932] and Zhang Jinsheng [1728 2516 3932]: "A Group Army Keeps in Mind Dealing With Suddenly Occurring Situations in the Period of Peace and Improves Its Capability To Resist Local Invasions by the Enemy"]

[Text] "Mobility and counter-mobility, breakthrough and counter-breakthrough, operations by high-speed detachments to support the border, and three-dimensional coordination by combined arms forces to drive the enemy out of the country..." These were some of the new things revealed in a campaign exercise on resisting an enemy's local invasion. The exercise was held in the middle of September by a group army in the Shenyang Military Region in order to improve its capability for dealing with suddenly occurring situations in the period of peace. The army's explorations in this respect were praised by the leaders of the General Staff Department and by some training experts who had come from a discussion and emulation exercise.

Since the beginning of this year, the group army, with guidance and help from the higher-level organizations and keeping in mind the new situation in which there is a period of peace and a major war will not break out, made dealing with a suddenly occurring incident and resisting an enemy's local invasion a key topic in campaign training. The senior officers and leadership organizations of the group army analyzed data on a little over 20 local conflicts of a representative nature. They thoroughly explored their characteristics and laws, and in a focused manner organized their units to begin a series of training sessions. Through tests and verifications in this exercise, marked results were obtained in these training sessions.

Noting that local conflicts break out suddenly, they vigorously improved the units' speed in meeting emergencies and their mobility. Besides organizing the units to make use of the opportunities presented by rescue and disaster relief work to train in long-distance raids in which there are many forms of delivery, and organizing specialist units to train in laying bridges underwater, crossing rivers stealthily, swiftly penetrating the enemy's rear, and other rapid operations and support, they paid attention to training for enhancing the capability of command organizations to conduct rapid operations and command. This training made the commanders and organizations at all levels able to master the methods of organizing and commanding many modes of movement on railways, on highways, on waterways, and in the air. They also vigorously made an innovation in the means of command by putting micromputers in the field command car, so that there was automatic command while on the move. During the exercise, under the circumstances in which orders were given suddenly, the terrain

was unfamiliar, the "enemy's" situation was complex, and the roads were muddy, some of the units taking part in the exercise rushed forward by motorized means, some of them moved by rail, and some were transported by air. They cut paths through mountains and built bridges across rivers, traveling both day and night. Not a single vehicle or gun was overturned, and not a single man was injured. In a fairly short time they arrived at the predesignated operational zone, which was over 400 to 900 kilometers from where they were currently stationed, thereby completing the launching of the campaign.

Based on the fact that local conflicts are quite dynamic and random, the group army strove to train its units in many kinds of combat skills. During the exercise the directing unit set up many complex situations, causing the operational modes to change abruptly. Some units had just finished an airlanding when they had to switch to the holdfast defense of a strategic point; some units, for more than 20 hours in succession, carried out 3 different types of operational missions. Because in peacetime they pay attention to enhancing the study of tactics for confronting an enemy's local invasion, they consciously trained the units to carry out one by one many types of operational missions. Also, measures were taken to improve the physical strength and endurance of the officers and men. Thus they did quite well in forcing the enemy to change when we changed and controlled change with change, seizing the initiative on the battlefield.

A campaign transcends ordinary practice. Combined arms command on the battlefield is complex, the campaign movements are severely restricted by nonmilitary factors such as politics and diplomacy. There are other prominent characteristics in a campaign to resist an enemy's local invasion during a period of peace. In this exercise the higher level not only decided that the group army would bring all the service arms in its establishment to the exercise, but also attached to it a large number of air, air defense, antitank missile, and armored units, as well as electronic warfare, pontoon bridge, and other specialist units. Faced with a battlefield that was several tens of thousands of square kilometers in size, and with a crisscrossing network of operational movement in the air, on the ground, at the front, and at the flanks and rear, the leaders of the group army carefully organized, skillfully devised strategies, and rationally deployed their units. Thus they commanded well the operations at every stage of the campaign, not only making the large number of "crack troops and sharp weapons" play their proper role, but also closely combining the military struggle with the political and diplomatic struggles in order to smash even more forcibly the "enemy's" regional invasion.

### **Military Hospitals Said Providing Unequal Treatment**

40050057c Beijing JIEFANGJUN BAO in Chinese  
7 Nov 87 p 1

[Article: "Before Seeing a Patient the Doctor First Sees What Money the Patient Has; For the Same Illness the Doctor Prescribes Different Prescriptions"]

[Text] Beijing, 6 November—Gao Jianlin [7559 1696 2651] and Yuan Yuedong [5913 6460 2639] of a certain unit in the Shenyang Military Region today reported to this newspaper's editorial department that in the hospitals of some units the phenomenon of "different prescriptions for the same illness" is quite serious. The reaction from patients has been strong, and the two readers hope to draw the attention of the relevant units to this phenomenon.

What is called the "same illness but different prescriptions" means that when a doctor is making a diagnosis and treating an illness he gives a local patient expensive medicines and a patient from a military unit common medicines. The analysis made by Gao Jianlin and Yuan Yuedong found that the main reason for the "same illness but different prescriptions" was that, in order to arouse the work enthusiasm of medical personnel, the hospitals of some units mechanically copy the practice of local hospitals by instituting the bonus responsibility system. Therefore, some medical offices are willing to accept more local patients, because in this way they sell more medicines and expensive medicines (this is because some patients who enjoy free medical services do not care how much money is spent) and the individual medical practitioner thus gets more bonuses. However, for patients from military units there is a monthly limit on medical treatment expenses, and if this limit is exceeded the hospital that receives the patients for treatment must make up the difference. Viewing the actual situation over the years, we see that the medical treatment expenses of almost every patient after he leaves the hospital have exceeded the limit set by the higher level. If a hospital admits and treats a patient from a military unit, not only does it not make money, it loses money. Therefore, some medical offices are unwilling to prescribe good medicines for patients from military units, but they give the "green light" to local patients.

According to reports, some military hospitals handle this problem fairly well. From first to last, they insist on the aim of serving the troops. They have taken specific measures for giving priority to military patients in hospital registration, hospital stay, and medicines. They withdraw from production income a special fund for use in treating military patients.

**16,200 Taiwan Visitors Since 2 November**

*OW091122 Beijing XINHUA in English  
0642 GMT 9 Jan 88*

[Text] Beijing, January 9 (XINHUA)—Taiwan compatriots have been coming to China's mainland at the rate of about 265 a day since last November 2 when island authorities lifted a ban on such travel.

Over the first two months 16,200 Taiwan compatriots visited the mainland; 13,900 have already left.

To date, 25,199 Taiwanese have applied to come; most are to visit relatives.

More than 14,000 are expected to arrive for the Spring Festival, the Chinese lunar new year which falls this year on February 17.

Most of the visitors are around the age of 50. They have been to all mainland provinces and autonomous regions except Tibet.

The visitors receive priority treatment at frontier posts, railway stations, airports and customs. Many local agencies of China Travel Service have set up special reception sections for them.

The Guangzhou Civil Aviation Bureau reserves 667 seats for Taiwan visitors every week on its 18 air routes.

Meanwhile, the China Red Cross has received 20,100 letters from the mainland and 682 from Taiwan asking for help in locating relatives on both sides of the Taiwan Strait.

**100,000 Taiwanese Expected To Visit China This Year**

*OW100751 Beijing XINHUA Domestic Service in Chinese 1505 GMT 9 Jan 88*

[Text] Hong Kong, 9 Jan (XINHUA)—According to a Taipei dispatch, at a news conference yesterday, Taiwan's "Interior Minister" Wu Boxiong said that since the Taiwan authorities lifted the ban on travel to the Chinese mainland on 2 December last year, 31,840 people had applied through the Taiwan Red Cross Society to visit relatives on the mainland, and 25,657 people had been approved by the authorities to visit their relatives. He said that 11,404 people had left Taiwan, and 8,930 people had returned to Taiwan after visiting their relatives.

Wu Boxiong said: Since the beginning of this year, many people in Taiwan have planned to go to the mainland to spend the Chinese Lunar New Year there. Therefore, Taiwan compatriots' visits to the mainland to see relatives is entering a peak period. On 6 January alone, more than 40,000 Taiwan compatriots submitted applications to visit the mainland.

It is expected that the first peak of the mainland visit fever of Taiwan compatriots will come around this year's Spring Festival.

Sixty-three percent of the applicants are common people, with demobilized servicemen and their dependents representing the second highest percentage of the applicants; businessmen comprise the majority of the common applicants, accounting for 34.2 percent. Because the Taiwan authorities ban government servants from visiting the mainland, many homesick public servants on Taiwan have retired ahead of schedule. In November last year alone, the number of public servants who retired voluntarily retired increased 1.4 times over the same period in 1986. It is expected that the number of public servants who apply for early retirement will increase considerably this year.

According to a research fellow of the "China Economic Research Institute" of Taiwan, at least 100,000 Taiwan compatriots will visit the mainland this year to have a reunion with their relatives.

### **Pressure for Direct Trade with China Begins To Mount in Taiwan**

40060105 Hong Kong CHIU-SHIH NIEN-TAI [THE NINETIES] in Chinese No 1, 1 Jan 88 pp 68-69

[Article by Nan Fangshuo [0589 2455 2592]: "New Demands for Trade between the Two Sides of the Taiwan Strait: Indirect Trade between the Two Sides Continues To Grow and Has Already Reached \$2.5 Billion; Medium and Small Enterprises, Pressured by the Rising New Taiwan Dollar Are Urging Trade with the Mainland; Trade Will Strengthen the Competitiveness of Taiwan Products and Will Provide a Way out for Sunset Industries and For the Stockpile of Foreign Exchange; But Postal and Air Links Must Come First, so Official Contacts Certainly Cannot Be Avoided; This Is a Real Thorny Problem for the KMT"]

[Text] Demand for opening of direct trade between the two sides of the Taiwan Strait has finally been raised on Taiwan. In the wake of the decision to permit Taiwan residents to "visit relatives" on the mainland, a new, more practical issue, one that has much more far-reaching implications, has arisen.

The demand for direct trade did not appear until December, and it was female economist Bian Yuyuan [6708 5940 3220], director of the Department of International Trade of National Taiwan University, who started the ball rolling. At a symposium convened in early December, she opening stated that indirect trade between the two sides of the Taiwan Strait continues to grow and now totals \$2.5 billion, including entrepot trade carried out in Hong Kong, Japan, Singapore and other ports. And Taiwan's medium and small enterprises, under pressure from the steadily rising New Taiwan Dollar [NT dollar], are about to "lose their necks." Under these conditions, Bian concluded, direct trade would help give these enterprises some breathing room.

### **A New Escape Route for Taiwan's Trade**

After Bian's call for direct trade, the Economic Committee of the Nationalist's Legislative Yuan convened on 10 December a hearing on foreign exchange rates, which a number of representatives from medium and small electronic, toy and textile companies were invited to attend. These representatives almost unanimously testified that, with the steadily rising NT dollar, Taiwan's medium and small enterprises were having an increasingly difficult time surviving; thus the representatives echoed the call for opening direct trade with the mainland. Since these calls violated current national policy, the procedural departments of the Legislative Yuan struck all mention of trade with the mainland from the transcripts of each person's speech.

To date, Taiwan still officially treats the Chinese Communists as "armed rebels" and thus firmly opposes the "three openings"—of postal, air and trade links—with the mainland. Even though entrepot trade has grown to

\$2.5 billion, that trade still "is something you can do but not mention," and the authorities merely wink at and do not make any to ferret out and punish it. Trade ties presuppose postal and air links, but these latter links, as well contacts in such areas as customs duty, unavoidably would involve official contact between the two sides. Thus, for all intents and purposes, trade ties would be tantamount to "one opening leads to a hundred." This is the reason why Taiwan's academic and business circles were so slow and even afraid to express their view on the opening of trade. But now, scholars and medium and small enterprises have taken the bold risk of demanding direct trade. Their reasoning merits special note and analysis.

### **The Continued Rise of the NT Dollar Has Increased the Pressure on Taiwan**

The bulk of Taiwan's economy has always consisted of medium and small enterprises, which account for more than 97 percent of all industrial firms and for 72 percent of all foreign trade. This shows that these enterprises are the lifeblood of the Taiwan economy. Nevertheless, over the past 2 years, since the end of 1985, the NT dollar has steadily appreciated and has risen much faster against the U.S. dollar than the currencies of the other three little dragons of Asia, and this has reduced the competitiveness of Taiwan products accordingly. A short time ago, representatives of the island's academic institutions and entrepreneurs conducted a survey which found that Taiwan's businesses would not be able to survive if the NT dollar rose to 28:1 against the U.S. dollar. For this reason, even though the NT dollar continued to rise, Taiwan authorities for a half year or more have insisted that they will draw the line at and not allow the U.S. dollar to fall below 30:1. This stand, however, began to give way in November and December.

First, the American economic crisis became strikingly apparent after the 19 October crash of the U.S. stock market. Then the U.S. government's figures for October and November showed unexpectedly that the U.S. trade deficit had continued to worsen during those months. Because the budget and trade deficits were key factors behind the fall of the U.S. dollar, the fact that the trade deficit was continuing to mount indicated that the dollar could not be stabilized. Beginning in December, American monetary officials indicated that they would allow the dollar to continue to slide, and this decision led to an unbroken fall in the dollar.

Due to these factors, the United States naturally was not inclined to reduce its pressure on Taiwan, which has a \$74 billion in foreign exchange reserves. In early December, Ch'ien Fu [Frederick Chien; 6929 1788] Taiwan's representative in the United States, returned to Taiwan and apprised the authorities of the wishes of American financial agencies. This event caused Taiwan's Central Bank to begin to "abandon" its last line of defense



against the continued climb of the NT dollar. Most estimates are that the NT dollar will again break the 28:1 mark by the end of the year.

#### **There Is a Real Need for Trade Contacts across the Taiwan Strait**

As the NT dollar approaches the limit of tolerance for medium and small enterprises, these firms are finding it more and more difficult to stay in business. Export orders for the month of December fell markedly, and loan-holding banks have begun to report closings or shut-downs of many firms.

Against this backdrop, it becomes clear that the call for direct trade with the mainland was motivated by the desire to find a way out for the vast majority of Taiwan's medium and small firms. Direct-trade advocates advance their arguments for essentially two basic reasons.

First, there is a real need for trade contacts across the Taiwan Strait. The mainland urgently needs Taiwan's industrial goods, such as textiles, glass and electronics, and Taiwan has a pressing need for the agricultural and industrial raw materials the mainland produces. The fact that the trade between the two sides can only be conducted indirectly adds to the costs of that trade and gives nations in which the entrepot trade is transacted a share of the profits. South Korea now carries out direct trade with the Chinese mainland and thus is able to import coal from China and thereby reduce her own energy costs. Hong Kong and Singapore also have close economic and trade relations with the mainland. Thus opening trade with the mainland will give Taiwan a source of cheap agricultural and industrial raw materials, and mainland markets, which remain undeveloped, offer excellent prospects for Taiwan goods.

Second, direct trade bypassing third countries, including imports and exports and exports of capital and industries, provides an effective means of cutting through Taiwan's knotty problems, such as finding a way out for the island's sunset industries and reducing the island's massive foreign exchange holdings.

It is known that the economic strategy of the Taiwan authorities has always been to avoid any entangling ties with the mainland, and over the past 1 or 2 years, the authorities have even attempted to employ policy inducements to prevent the growth of such ties. For example, in an effort to check the growth in Taiwan's foreign exchange reserves, the authorities have tried to encourage exports of capital and industries to Southeast Asia. They have also striven to diversify Taiwan's markets in an effort to avoid sparking protectionist sentiment in the United States, the harm that might result from the appreciation of the NT dollar and the impetus both of these contingencies might engender toward closer ties between Taiwan and the mainland. And the Taiwan authorities have consistently striven to upgrade

industry in an effort to prevent the aging and consequent decline of Taiwan's industry to a level at which the industry would have to compete or even cooperate with the mainland. However, Taiwan has been unable to effect any major restructuring of her economy.

Take for example the island's effort to upgrade her industry. In recent years, Taiwan authorities have drawn up a number of laws to encourage enterprises to combine to expand their scale of operations, and the authorities have sought to encourage strategic and upscale industries. Yet the bulk of Taiwan's firms remains medium and small in size, for these enterprises are adaptable, responsive and flexible. But when firms need to have foresight and to make investments that are risky and that yield slower returns, the firms are not so responsive, and this has slowed Taiwan's effort to upgrade her industry.

And in the effort to export capital and industry, given the international division of labor, Taiwan's "sunset industries" theoretically ought to be able to become "sunrise industries" in certain Southeast Asian countries. Yet exporting capital and industry is by no means easy. These efforts require that exporters have excellent economic and social ties with the areas in which they are investing and that their own nation has considerable influence in the economies of those areas. Japan, for example, has almost always used her banks as the beach-heads for her advances abroad. Taiwan, on the other hand, greatly lacks this kind of a base in the countries of Southeast Asia. And it is precisely for this reason that Taiwan's effort to export capital has never proved very effective, even though the island relaxed her foreign exchange controls. For example, her total capital exports to Thailand, a Southeast Asian country that is very stable and that has the least amount of cultural conflict with Taiwan, have yet to reach \$100 million.

Conversely, the two sides of the Strait have similar language and cultures, and both clearly stand to gain from trade. In recent years, in addition to flourishing entrepot trade with the mainland, Taiwan has also begun to introduce capital into China. The mainland's Association for Establishing Friendly Liaison with Taiwan Compatriots reports that in recent years there have been 39 cases of direct investment by Taiwan businessmen in China. And in November newspapers reported that, due to the clear decline of the plastic sole shoe industry on Taiwan, three shoe firms from the island have already invested and set up complete new factories on the mainland. These examples illustrate that as the inertia of Taiwan's medium and small enterprises makes things more and more difficult for those firms, the firms will begin to focus more of their development on the mainland.

Not long ago, Chao Yao-tung [6392 5069 2639], chairman of the Economic Development Council of the Nationalist's Executive Yuan, stated, "On the heels of the decision to permit visits to relatives on the mainland

will come economic and trade problems. One of the important issues we must address is how to respond to these changing conditions." Chao's remarks were right on the mark.

Given the recent development of Taiwan's economy, the NT dollar is bound to continue to appreciate, but it remains unclear how far it will rise. But because Taiwan's foreign exchange holdings continue to mount, economic committees in the U.S. Congress say that the NT dollar will top off between 20 and 25:1 against the U.S. dollar. It is precisely this kind of pressure that will make Taiwan's medium and small enterprises press for direct trade with the mainland.

#### **A Clearer "Mainland Economic Policy" Is Required**

The problem is that the two sides of the Taiwan Strait are still in a state of hostility, and direct trade will require ideological changes on both sides, so the matter has complex ramifications. In general, Taiwan advocates of direct trade believe that the issue must be confronted, and to do this Taiwan clearly must do the following. (1) Taiwan must formulate a clearer policy on economic relations with the mainland. The economies of the two sides are both antagonistic and complementary. The development of the mainland's economy, once that occurs, could prove disadvantageous to the economy of Taiwan. To avoid this possibility, Taiwan, in her economic development, must focus on the complementary nature of the economies of the two sides. Taiwan's entrepreneurs are apt to follow only a policy that does this.

(2) It appears that Taiwan must design a policy that separates the political from the economic aspects of the island's relations with the mainland so as to reduce or slow the political effects engendered by economic ties.

(3) As economic and trade relations with the mainland grow, Taiwan may have to make many special arrangements. For example, to keep the Chinese Communists from using trade as a political weapon, Taiwan should not allow herself to become overly dependent on her relations with the mainland. As a precaution against the possibility that the mainland might cancel orders or rescind trade agreements with Taiwan, the island should set up a special import-export insurance system. And to prevent the mainland from exerting too great an influence within Taiwan, the island might have to restrict trade to specially designated ports.

Taiwan's relations with the mainland are very complicated. Things were more simple in the past, when visits to relatives, travel and cultural and commercial ties were conducted through third countries. Recent developments, however, stem from problems within Taiwan, itself, where people are beginning to call for further progress and to direct trade ties with the mainland. It is anticipated that during 1988, with the continued appreciation of the NT dollar, the demand for such ties will grow. This will probably prove to be the most nettlesome problem of the past 40 years.

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